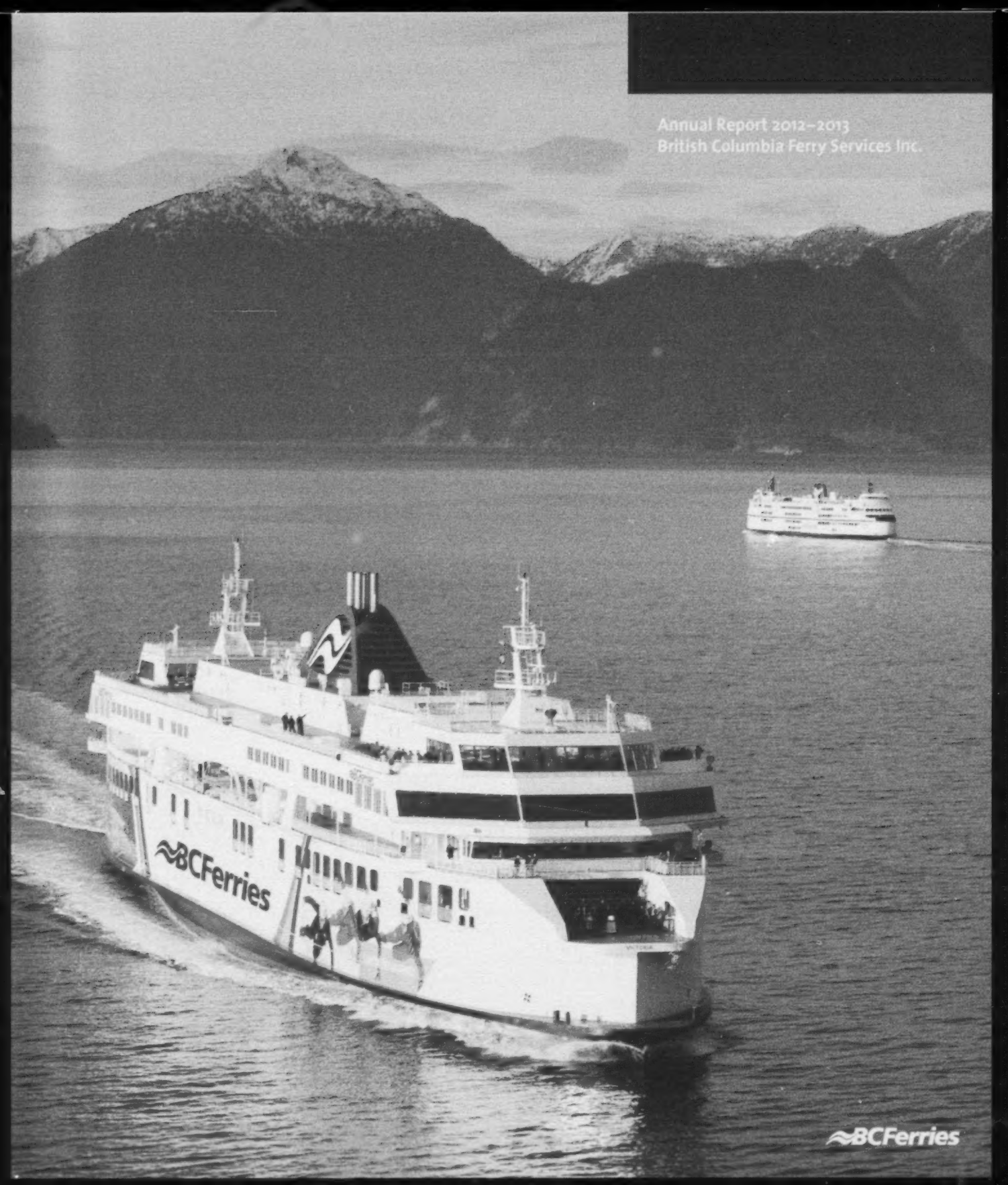

Annual Report 2012–2013
British Columbia Ferry Services Inc.
BCFerries
BCFerries

BRITISH COLUMBIA FERRY SERVICES INC.

Corporate Profile ____ 2
Message from the Chair ____ 4
Message from the President & CEO ____ 5
Key Accomplishments ____ 6
Performance Measures ____ 9
Key Cost Drivers ____ 10
Management's Discussion & Analysis of Financial Condition and Results of Operations ____ 11
Consolidated Financial Statements ____ 70
Corporate Directory ____ 103

This report contains certain "forward looking statements". These statements relate to future events or future performance and reflect management's expectations regarding our growth, results of operations, performance, business prospects and opportunities and industry performance and trends. They reflect management's current internal projections, expectations or beliefs and are based on information currently available to management. Some of the market conditions and factors that have been considered in formulating the assumptions upon which forward looking statements are based include traffic, the Canadian Dollar relative to the US Dollar, fuel costs, construction costs, the state of the local economy, fluctuating financial markets, demographics, tax changes, and the requirements of the Coastal Ferry Services Contract.

Forward looking statements included in this document include statements with respect to:

- our short and long-range business plans;
- our asset renewal programs for vessels and terminals;
- our customer service program, cable ferry initiative, and liquefied natural gas plans; and
- the Province's role regarding service levels and a long-term vision for connecting coastal communities.

In some cases, forward looking statements can be identified by terminology such as "may", "will", "should", "expect", "plan", "anticipate", "believe", "estimate", "predict", "potential", "continue" or the negative of these terms or other comparable terminology.

A number of factors could cause actual events or results to differ materially from the results discussed in the forward looking statements. In evaluating these statements, prospective investors should specifically consider various factors including, but not limited to, the risks and uncertainties associated with traffic volume and tariff revenue risk, safety and security, asset risk, accident risk, tax risk, environmental risk, regulatory risk, labour disruption risk, limitations of vessel repair facilities, risk of default under material contracts and aboriginal land claims.

Actual results may differ materially from any forward looking statement. Although management believes that the forward looking statements contained in this report are based upon reasonable assumptions, investors cannot be assured that actual results will be consistent with these forward looking statements. These forward looking statements are made as of the date of this report, and British Columbia Ferry Services Inc. assumes no obligation to update or revise them to reflect new events or circumstances except as may be required by applicable law.

In addition to providing measures prepared in accordance with IFRS, we present certain supplemental non-IFRS measures. These include, but are not limited to, vehicle and passenger traffic, on-time performance, fleet reliability scores, employee and passenger safety scores, customer satisfaction ratings, costs per passenger, and EBITDA. These measures do not have any standardized meaning prescribed by IFRS, and therefore are unlikely to be comparable to similar measures presented by other companies. These supplemental non-IFRS measures are provided to assist readers in determining our ability to generate cash from operations and improve the comparability of our results from one period to another. We believe these measures are useful in assessing operating performance of our ongoing business on an overall basis.

CORPORATE PROFILE

BC Ferries is one of the largest ferry operators in the world, providing year-round vehicle and passenger service on 25 routes to 47 terminals, with a fleet of 35 vessels. We are an essential transportation link that connects coastal communities and facilitates the movement of people, goods and services. In fiscal 2013, we carried 19.9 million passengers and 7.7 million vehicles throughout coastal British Columbia.

OUR VISION

To provide a continuously improving west coast travel experience that consistently exceeds customer expectations and reflects the innovation and pride of our employees.

OUR MISSION

To provide safe, reliable and efficient marine transportation services which consistently exceed the expectations of our customers, employees and communities, while creating enterprise value.

OUR VALUES

Safety: Ensure that the safety and security of our customers and staff is a primary concern in all aspects of doing business.

Quality: Be motivated by customer expectations in providing quality facilities and services.

Integrity: Be accountable for all our actions and ensure we demonstrate integrity in our business relations, utilization of resources, treatment of our customers and staff, and in the general conduct of our business.

Partnerships: Work openly and constructively with our various business and community stakeholders to exceed the expectations of our customers and advance each other's interests.

Environment: Ensure that environmental standards are maintained.

Employees: Always deal from a position of honesty, integrity and mutual respect, and ensure that our employees develop to their full potential.

OUR GOALS

In support of our vision, we are focused on five key goals, none more important than safety.

1. Safety: To protect our customers and employees by continuously improving the safety of our operations, inclusive of vessels, terminals and facilities.

2. Operational Reliability: To continuously improve the operational reliability of vessels, terminals and facilities.

3. Continuous Improvement: To be better at everything we do.

4. Value For Money: To continuously improve value to our customers at every point along the customer experience chain.

5. Financial Integrity: To achieve key financial targets, ensuring that sufficient capital and retained earnings are available to revitalize our fleet, facilities and infrastructure.

MESSAGE FROM THE CHAIR OF THE BOARD OF DIRECTORS

We are pleased to see that 88 per cent of passengers reported being satisfied with their overall experience travelling on BC Ferries.

On behalf of the Board of Directors of British Columbia Ferry Services Inc., we extend our sincere thanks to all of the employees of BC Ferries for another successful year of providing safe and outstanding service to the approximate 20 million customers that sailed throughout the fleet.

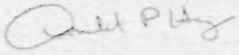
We are pleased to see that 88 per cent of passengers reported being satisfied with their overall experience travelling on BC Ferries. Customers gave us high marks in the areas of safety, staff courtesy and cleanliness of the vessels among other attributes. These impressive results clearly reflect the dedication and commitment of our staff. We are also very aware that customers have concerns about the affordability of fares. We are running the business as efficiently as possible and constantly looking for ways to reduce costs without compromising safety.

During the fall of 2012, the provincial government conducted a public consultation and engagement process for input on service level adjustments and on a long-term vision for coastal ferry service. As the service provider, it's our job at BC Ferries to provide safe and efficient ferry service along coastal British Columbia. Ferry service levels are a public policy decision by the provincial government. We await direction from the Province regarding any potential adjustments to our service levels and the resulting impact on fares.

I join the BC Ferry Services Inc. Board in welcoming new members Jane M. Bird, John A. Horning and Guy D. Johnson to the Board. They each bring a wealth of additional experience and knowledge to the Board. I extend special thanks to retiring Board members Holly A. Haston-Grant and Wayne H. Stoilen for their years of service.

The Company has recently navigated through challenging times by exercising strong fiscal leadership, and I congratulate the efforts achieved by the management team and our employees. While we still have concerns about the current economic conditions and traffic levels, we remain optimistic about the year ahead.

In our next year of operations, we will continue to make safety our top priority as we constantly strive to provide the best possible travel experience for our customers to enjoy.



DONALD P. HAYES
Chair of the Board of Directors
British Columbia Ferry Services Inc.

MESSAGE FROM THE PRESIDENT & CEO

As I reflect back on the last year, I am proud of the many accomplishments we've made at BC Ferries in the areas of safety, customer service, investments in our ships and terminals, as well as solid fiscal management. I thank each and every employee for their individual efforts which contributed to our many successes in all areas of the Company.

Phase III of our SailSafe program (the sustainment phase), a joint initiative with the BC Ferry & Marine Workers' Union, is now underway. Phase III marks the formal shift from a defined safety program implementation to a regular part of our business as an on going commitment to safety excellence that is fully integrated into our daily work. It helps entrench safety in all aspects of our operations and becomes part of our culture. Since SailSafe began in 2007, we've seen a reduction in time loss injuries of over 50 per cent.

While carrying out our mandate to ensure safety at all times, we have been actively managing our costs. Through prudent fiscal stewardship we are pleased to return to a position of profitability, despite slightly lower than expected ridership. Not only were we successful from a financial perspective, our on-time performance reached 92.3 per cent, coupled with a vessel reliability index of 99.8 per cent.

With the major and northern vessel replacement program concluded, we have turned our attention to the refurbishment of minor and intermediate size vessels. With fare affordability in mind, we plan to build standardized vessels to achieve interoperability and design optimization. New ships also allow us the opportunity to explore the use of liquefied natural gas as a fuel source, which is not only currently 50 – 60 per cent cheaper than marine diesel, it is also better for the environment.

In November 2012, we announced that we were proceeding with our plans to design and build a cable ferry which will operate between Buckley Bay on Vancouver Island and Denman Island. The cable ferry is expected to enter service in the fall of 2014, and to provide a substantial cost savings of over $80 million over the 40-year project life compared to the current service.

Two non-traditional revenue sources that continue to perform well for us are the drop-trailer segment of our Commercial Services division and BC Ferries Vacations. Generating revenue from areas other than the farebox helps to reduce upward pressure on ferry fares. These two lines of business generated revenues of over $10 million this year.

While carrying out our mandate to ensure safety at all times, we have been actively managing our costs.

BC Ferries has embarked on an extensive, multi-year integrated business solution project to improve the end-to-end customer experience. The program called Automated Customer Experience (ACE) will replace two of our primary business systems, Point-of-Sale and Reservations, and will introduce new services to enhance our overall level of customer service, especially in the areas of mobility and social media. As we implement ACE over the next several years, we remain focussed on our goal of providing the best possible service for the millions of passengers that travel with us each year.

As always, the safety and reliability of our service remains my number one priority for both our employees and our valued customers. We expect to continue to deliver another strong financial performance in the year ahead and look to the future with confidence.

MICHAEL J. CORRIGAN
President & Chief Executive Officer
British Columbia Ferry Services Inc.

KEY ACCOMPLISHMENTS

IMPROVING THE TRAVEL EXPERIENCE...

- Reached a fleetwide on-time performance record of 92.3 per cent.
- Achieved a vessel reliability index of 99.75 per cent.
- Expanded free wireless Internet service on all ships servicing the Horseshoe Bay – Departure Bay and Horseshoe Bay – Langdale routes, as well as at these three terminals. The service enables our customers to email and browse the Internet.
- Offered CoastSaver promotional fares for the three major routes connecting the Lower Mainland and Vancouver Island from May 25 to June 25, 2012.
- Generated $74.5 million in ancillary revenue in food and retail sales. While we impress shoppers and diners with new products, these services contribute valuable non-tariff revenue to our bottom line, which helps reduce pressure on fares.
- Continued our popular Coastal Naturalist Program on the Tsawwassen – Swartz Bay and Horseshoe Bay – Departure Bay routes for the summer months. In partnership with Parks Canada, the Coastal Naturalists offer customers a real life coastal experience.
- Released the results of our 2012 Customer Satisfaction Tracking surveys which indicated that 88 per cent of customers surveyed reported being satisfied with their overall trip experience.
- Offered free travel for children 11 years of age or under fleetwide over the new Family Day long weekend.
- Expanded the popular White Spot menu offerings on vessels servicing the Horseshoe Bay – Departure Bay route. New items include Tuscan Chicken Pasta, Bishop's Curry, wild Pacific Salmon burger and the iconic White Spot Pirate Pak.
- Over 50,000 customers have taken advantage of our travel packages since we started BC Ferries Vacations three years ago.

BUILDING A BETTER BC FERRIES...

- Embarked on phase III (the sustainment phase) of SailSafe, a joint safety initiative with the BC Ferry & Marine Workers' Union.
- Held 29 "Town Hall" sessions with over 400 employees to collaborate and brainstorm different avenues for improving workplace safety.
- Reduced employee injuries by 13 per cent and time loss injuries also declined by 13 per cent.
- Continued to develop and invest in our people through extensive technical training and orientation, succession planning and sponsored development for our officers and significant leadership training for our managers and supervisors.
- Adjusted service levels on underutilized sailings on the major routes between Vancouver Island and the Mainland to save approximately $1 million per year.
- Provided technical and subject matter support for a government-led consultation and engagement process regarding the immediate challenges and long-term vision for the coastal ferry service.
- Reached an agreement on property tax assessments with BC Assessment, the Province and the municipalities of jurisdiction that ensure BC Ferries is paying fair and reasonable property taxes throughout all service areas. This agreement provides predictability for BC Ferries and helps us mitigate pressure on ferry fares.
- Marked a major milestone in our Commercial Services division by carrying our 75,000th drop-trailer in February 2013.
- Completed the upgrade of our Micros catering system.
- Successfully rolled out the Standardized Education and Assessment (SEA) program to six additional operational positions. Half of all operational positions at BC Ferries are now using the SEA Training approach and materials when training employees on their new job duties.
- Increased the total number of qualified trainers in the Company to over 220 and expect to grow the training team to 400 by the time SEA is fully implemented by March 2015.
- Submitted a fuel strategies report to the BC Ferries Commissioner which included our plan to transition to alternate fuels. We have been studying the feasibility of using liquefied natural gas and believe that a move to this fuel source could reduce costs and emissions.

INVESTING IN OUR VESSELS AND TERMINALS...

- Conducted 13 drydockings and 23 refits on our fleet of 35 ships this year.
- Conducted the first heavy lift of a vessel, the MV Nicola, at the Company's Fleet Maintenance Unit at Deas Dock in Richmond, B.C. with the use of a floating crane. By lifting the vessel out of the water, BC Ferries performed all the work that normally requires a drydock.
- Announced plans to design, build and operate a cable ferry between Buckley Bay on Vancouver Island and Denman Island. The new 50-car vessel is expected to be in service by the fall of 2014.
- Completed a $43 million multi-year sewage and waste water treatment program to upgrade 27 vessels for treatment of sewage generated onboard the vessels.
- Completed a $20 million multi-year project for the upgrade of berths 4 and 5 at Swartz Bay terminal which included replacement of ramps, ramp abutments, aprons, towers, wingwalls, dolphins and floating leads as well as electrical upgrades and a new waiting shelter.
- Commenced a $16 million project to extend the life of the Tachek by an additional 15 years until retirement in 2029.
- Installed a new $1.5 million tie-up arrangement and catwalk system at Prince Rupert terminal to address safety concerns raised by staff through our All Learning Events Reported Today (ALERT) program.
- Created a new operational training c re at our Fleet Maintenance Unit in Richmond that includes a refurbished classroom, new davit, rescue boat and life saving appliance training slide.
- Conducted a $2.9 million project to upgrade the ramps at all three berths at Horseshoe Bay terminal.
- Spent $1.5 million to replace a dolphin and modify another at Snug Cove terminal on Bowen Island.
- Undertook a $1.3 million shoreline stabilization project at Tsawwassen terminal to install a filter layer and rip rap to increase the stability and drainage along the causeway shoreline.

KEY ACCOMPLISHMENTS

CONNECTING WITH THE COMMUNITIES WE SERVE...

- Performed 21 marine rescues throughout coastal British Columbia including the June 18, 2012 rescue of a man in an overturned canoe by the *Kuper* crew and the December 19, 2012 rescue of a hypothermic man from the waters off Gabriola Island by the *Quinsam* crew.
- Conducted 58 dedicated ambulance runs to transport people requiring urgent care from smaller island communities to emergency medical treatment.
- Raised $50,000 for the David Foster Foundation, which provides financial support to families of children across Canada requiring organ transplants, through the BC Ferries Media Charity Golf Classic. Over the past seven years, these tournaments have raised over $450,000 to support children's programs.
- Combined efforts with Island Pathways Velo Village event organizers to arrange a charter sailing from Swartz Bay to Salt Spring Island. Over 200 cyclists travelled on BC Ferries' first ever cyclists-only sailing.
- Pledged $64,000 in employee contributions in the 2012 United Way Campaign.
- Consulted regularly with our 13 Ferry Advisory Committees.
- For the ninth consecutive year, BC Ferries' employees raised money to donate to a local food bank through the annual BC Ferries' Employees Golf Tournament. The 2012 tournament raised $2,800 for the Powell River Food Bank.
- Presented a "Born On Board" card to the family of a newborn baby boy. This latest addition to a Quadra Island family took his first breath on the *Powell River Queen* while his family was rushing him to medical care in Campbell River on August 15, 2012. The card will entitle the child to free, lifetime travel as a passenger on all BC Ferries routes.
- Sponsored the BC Bike Race, Sport BC, the Powell River Kings Junior "A" Hockey Club and the Victoria Highlanders Football Club.
- Held public information sessions regarding the upcoming berth replacements, at Westview and Little River terminals (which services the Powell River – Comox route), as well as at Alert Bay terminal.

In support of our Vision, Mission, and Definition of Success, the Board of Directors and management of BC Ferries have implemented comprehensive long-term performance measures to gauge the progress of the business and its ongoing commitment to continuous improvement.

The safety of our passengers and employees are our primary focus:

1 Employee Safety (employee injury frequency rate X severity rate divided by 1000)

2 Passenger Safety (number of passenger injuries per one million passengers)

	Fiscal 2011		Fiscal 2012		Fiscal 2013	
	Actual	Target	Actual	Target	Actual	Target
Employee Safety	1.53	1.56	1.34*	1.31	1.04	1.22
Passenger Safety	17.09*	21.50	15.31	18.11	13.28	15.45

*restated

Other important areas of focus include:

3 Reliability (actual round trips divided by scheduled round trips, less weather, medical or rescue related cancellations)

4 Customer Satisfaction Rating

5 Cost per passenger (total operation cost-ancillary revenue) / total passengers

6 Earnings before interest, taxes, depreciation and amortization (EBITDA, in $ millions), including the impact of our rate regulated assets and liabilities.

	Fiscal 2011		Fiscal 2012		Fiscal 2013	
	Actual	Target	Actual	Target	Actual	Target
Reliability Index [1]	99.83%	99.4 – 99.59%	99.76%	99.4 – 99.59%	99.75	99.5 – 99.69%
Customer Satisfaction	89%	84%	88%	83%	88%	88%
Cost per Passenger	$ 21.90	$ 21.66	$ 23.04	$ 23.29	$ 23.74	$ 23.85
EBITDA (millions) [2]	$ 180.9	$ 195.6[3]	$ 177.3	$ 176.2	$ 221.7	$ 206.4

1 The reliability index has been recalculated for fiscal 2010 and fiscal 2011 to represent actual round trips divided by scheduled round trips less weather, medical or rescue related cancellations.

2 Commencing in fiscal 2013 BC Ferries financial reporting was prepared in accordance with International Financial Reporting Standards (IFRS). Major overhauls and inspections are now capitalized rather than expensed and training and feasibility costs associated with capital projects being expensed rather than capitalized under Canadian generally accepted accounting principles (for further discussion please see our Fiscal 2014 Business Plan).

3 Restated.

KEY COST DRIVERS

The major strategic issue facing us when we were established as an independent company on April 1, 2003, was the replacement of our aged assets, specifically vessels, terminals and information technology systems.

Since that time, we have invested $1.9 billion to bring seven new vessels into service, upgrade 17 existing vessels, make numerous improvements to terminals and marine structures, upgrade security, and implement sewage pump-ashore and waste water treatment systems. In fiscal 2013 alone, we completed 22 vessel refits, 1 vessel upgrade, 7 large terminal upgrades and various other projects. As a result of this significant investment in our assets, interest and amortization expenses have increased from $68 million in fiscal 2004 to $204 million in fiscal 2013, an increase of $136 million.

Beginning with the global economic downturn in 2008, we have experienced significant erosion in our traffic, reaching a 22 year low in passenger and vehicle levels. Concurrently, there has been considerable pressure on operating expenses. The cost of fuel has increased over 140% since 2004, along with increases in insurance premiums, property taxes, environmental and security regulations, utilities, benefit program rates and labour agreements.

While faced with these uncertain economic conditions, we have continued to focus on providing a safe, reliable and efficient marine transportation service. We have significantly reduced our time loss injuries and our WCB claim costs, at the same time improving our on time performance and reliability. Furthermore, fuel efficiencies were achieved resulting in an overall decrease in consumption of 4.8%, a savings of 5.8 million litres from fiscal 2004 and a reduction of over 8.3 million litres from fiscal 2003. In addition, administrative costs remained below those experienced in fiscal 2004, even before taking inflation into account.

($ millions)	Fiscal 2004 Actual[4]	Fiscal 2013 Actual
Operations Costs		
Labour	202	263
Fuel[5]	50	121
Materials, Supplies, Contracted Services and Other	33	33
Insurance[6], Property Tax, Utilities and Credit Card Fees	10	21
Maintenance Expenses	84	70[7]
Administration Expenses	32	30
Net Financing and Amortization[8]	68	204

4 The fiscal 2004 figures for Operations, Maintenance and Administration (OM&A) expenses have been adjusted from those figures previously reported to reflect classifications of expenses used in fiscal 2013. Total OM&A expenses for fiscal 2004 are identical to those previously reported.

5 Fuel reflects the total cost of fuel net of fuel price hedging gains or losses.

6 Insurance includes gains or losses from our subsidiary, BCF Captive Insurance Subsidiary Ltd.

7 Vessel major overhauls and inspections (MOI) were previously expensed as maintenance, under IFRS they are now capitalized and expensed over their expected life through amortization. For fiscal 2013, under CGAAP, $20 million in MOI would have been expensed to maintenance increasing the number to $90M.

8 Net Financing includes financing for the *Kuper* owned by our subsidiary, Pacific Marine Leasing Inc.

Looking forward, we will continue to pursue opportunities to minimize costs and work towards replacing or life-extending 11 of our aged vessels over the next 10 years. To support safe and efficient operations and minimize the impact on fares, we plan to build standardized vessels to provide interoperability and design optimization. We will also explore the use of liquefied natural gas as a fuel source. Liquefied natural gas is not only currently 50% to 60% cheaper than marine diesel, it is also better for the environment. We are also proceeding with plans to design and build a cable ferry to operate between Buckley Bay on Vancouver Island and Denman Island as announced in November 2012. The cable ferry is expected to enter into service in the fall of 2014 and will provide cost savings of over $80 million throughout the 40-year life of the project (as compared to the current service).

We continue to work with the Province on service level adjustments and a long term vision for connecting coastal communities. This will assist with decision making as we work towards replacement of our vessels and marine structures, terminal improvements and information system investments.

MANAGEMENT'S DISCUSSION & ANALYSIS

Management's Discussion & Analysis of Financial Condition and Results of Operations 12
Consolidated Financial Statements 70
Corporate Directory 103

Management's Discussion & Analysis of Financial Condition and Financial Performance for the fiscal year ended March 31, 2013

Dated June 21, 2013

The following is our discussion and analysis of the financial condition and financial performance for British Columbia Ferry Services Inc. (BC Ferries) as of June 21, 2013. This should be read in conjunction with our audited consolidated financial statements and related notes for the years ended March 31, 2013 (fiscal 2013) and March 31, 2012 (fiscal 2012). These documents are available on SEDAR at www.sedar.com and on our investor webpage at http://www.bcferries.com/about/investors/index.html.

Except where indicated, all financial information herein is expressed in Canadian dollars and determined on the basis of International Financial Reporting Standards (IFRS). Note 28 to our audited consolidated financial statements contains a reconciliation of key components of our financial statements formerly prepared under previous Canadian Generally Accepted Accounting Principles (CGAAP) to those prepared under IFRS as at and for the year ended March 31, 2012 and as at our transition date of April 1, 2011. Although the adoption of IFRS resulted in adjustments to our financial statements, it did not materially impact the underlying cash flows or long-term profitability trends of our operating performance.

Business Overview

British Columbia Ferry Services Inc. is an independent company providing ferry services on the west coast of British Columbia. We operate one of the largest and most complex ferry systems in the world. We provide frequent year-round transportation service with 35 vessels operating on 25 routes out of 47 terminals spread over 1,000 miles of coastline. We also manage ferry transportation service on other remote routes through contracts with independent operators.

Our service is an integral part of British Columbia's coastal transportation system and has been designated by the Province of British Columbia (the Province) as an essential service for purposes of the provincial Labour Relations Code. This designation means our services are considered necessary for the protection of the health, safety and welfare of the residents of British Columbia.

We provide a wide range of ferry services for our customers. During the year ended March 31, 2013, we provided over 183,800 sailings, carrying 19.9 million passengers and 7.7 million vehicles. We experienced a 1.1% decline in vehicle traffic and a 1.2% decline in passenger traffic in fiscal 2013 compared to the prior year. For a discussion of our traffic levels see "Financial and Operational Overview" and "Outlook – Traffic Levels" below.

Significant events during or subsequent to fiscal 2013:

- Effective April 1, 2012, the Coastal Ferry Services Contract (the CFSC) was amended for performance term three (PT3), being the period from April 1, 2012 to March 31, 2016. The amendment includes a reduction of up to 400 round trips in the minimum service requirement on our Major Routes expected to yield savings totalling $4 million over PT3, as well as principles and targets for further service level reductions system wide. These initiatives were expected to achieve efficiencies totalling $30 million over PT3. On April 3, 2013, the CFSC was subsequently amended to extend the deadline for identifying service level adjustments for the remainder of PT3, in order to provide sufficient time to the Province to further consult with stakeholders regarding future service changes. As part of the amendment, the Province agreed to pay us $7.1 million in ferry transportation fees to compensate for the change in deadline and to reduce savings from service adjustments from $30 million to $22.9 million. In recognition of this amendment, the British Columbia Ferries Commissioner (the Commissioner) issued an order updating his original PT3 price cap order, and acknowledged the $4 million in savings from service reductions already implemented with $18.9 million yet to be identified. (See "Corporate Structure – Economic Regulatory Environment" for more detail.)
- On May 9, 2012, the Province announced the introduction of the *Coastal Ferry Amendment Act 2012* (Bill 47), as well as a payment of $25.0 million relating to fiscal 2012 and a further $54.5 million over the following four fiscal years. Bill 47 received Royal Assent on May 31, 2012 and came into force on June 25, 2012. (See "Corporate Structure – Economic Regulatory Environment" for more detail.)
- On May 21, 2013, we released the results of our 2012 Customer Satisfaction Tracking Surveys which indicated that 88% of customers surveyed reported being satisfied with their overall trip experience. A copy of the full report is available on our website at http://www.bcferries.com/files/PDFs/BC_Ferries_PUBLIC_REPORT_CST_2012.pdf.

- On September 30, 2012, the Commissioner released the final price caps for the remaining three years of PT3, April 1, 2013 to March 31, 2016. These price caps represent increases averaging 4.0% per annum. The order indicated the Commissioner has the intention of allowing us to achieve, by the end of PT3, equity not lower than 17.5% of total capitalization and a Debt Service Coverage Ratio (DSCR) of 2.5 or higher. (See "Corporate Structure – Economic Regulatory Environment" for more detail.)
- On September 30, 2012, the Commissioner also released two additional orders; one established the terms and conditions for use of fuel price deferral accounts and the other established the criteria for determining major capital expenditures which require pre-approval by the Commissioner. Subsequently, the Commissioner released another order to extend the timeline for submission of our annual fuel reports. (See "Corporate Structure – Economic Regulatory Environment" for more detail.)
- On October 29, 2012, the Property Assessment Appeal Board of British Columbia issued its decision on our property assessment appeal relating to our Horseshoe Bay terminal. The Board ruled that the land and improvements, previously assessed at $42 million, $45 million and $48 million for years 2010, 2011 and 2012, respectively, have a nominal value of $20 dollars for each year. On February 14, 2013, we reached a five year agreement with the British Columbia Assessment Authority (the BCA), commencing with the 2013 tax year, which ensures we are paying fair and reasonable property taxes throughout all of our service areas. The agreement provides for a reduction in our total property taxes of approximately 20% or $1 million annually. In a separate agreement with the BCA and District of West Vancouver, we withdrew our appeals for all prior years.
- On November 23, 2012, we announced that we are proceeding with our plans to design and build a cable ferry for service between Buckley Bay on Vancouver Island and Denman Island. The new 50-car vessel is expected to be in service by the fall of 2014. (See "Investing in our Capital Assets" for more detail.)
- On November 30, 2012, as a result of declining fuel prices, all fuel surcharges were removed from our routes. Surcharges of 2.0% of tariffs on average had been in place since July 30, 2012 on all of our regulated routes with the exception of our Northern Routes. No surcharges or rebates were in place on our Northern Routes.
- On February 14, 2013, we were advised by the credit rating agency Standard & Poor's (S&P) that they have revised our outlook from negative to stable, reflecting their view of an improvement in regulatory certainty. S&P also affirmed our long-term rating of "A+". On March 26, 2013, DBRS affirmed our "A" rating with a stable trend. (See "Capital and Liquidity" for more detail.)
- On March 5, 2013, the Province released its report summarizing the input received during its eight-week public consultation and engagement process that completed December 21, 2012. The process sought public input on the principles to guide ferry service adjustment decisions and strategies to further the Province's long-term vision for the ferry system. We provided technical and subject matter support throughout this process. (See "Corporate Structure – Economic Regulatory Environment" for more detail.)
- On March 31, 2013, we reached an agreement with the Province, amending the CFSC, to consolidate all regulated routes into a single group effective April 1, 2013. This revised grouping will be in effect until March 31, 2016. In the absence of any further amendments, on April 1, 2016 the route group structure in the CFSC will revert back to the structure at March 31, 2013. (See "Corporate Structure – Economic Regulatory Environment" for more detail.)

Corporate Structure

COASTAL FERRY SERVICES CONTRACT (THE CFSC)

We operate ferry services under a regulatory regime as defined by the *Coastal Ferry Act* (the Act), and under the terms set out in the CFSC. This 60-year services contract with the Province, which commenced April 1, 2003, stipulates, among other things, the number of round trips that must be provided for each regulated ferry service route in exchange for specified fees (ferry transportation fees). The CFSC was amended to, among other things, establish the ferry service levels and ferry transportation fees for the second performance term (PT2) commencing April 1, 2008. The CFSC also includes fees for the provision of specific social program services delivered on behalf of the Province. The CFSC normally would have been amended for PT3 commencing April 1, 2012. However, this timeline was deferred by one year as a result of Bill 14 (see discussion below).

Under the terms of the CFSC, we also receive an annual amount from the Province based on its agreement with the Government of Canada to fulfill the obligation of providing ferry services to coastal British Columbia. The amount of this payment is adjusted annually based on the Consumer Price Index (CPI) (Vancouver).

ECONOMIC REGULATORY ENVIRONMENT

The office of the Commissioner was created under the Act, enacted by the Province on April 1, 2003. The Commissioner establishes price caps for designated ferry route groups for the purpose of regulating our tariffs. The Commissioner is also responsible for regulating the reduction of service, discontinuance of routes and certain other matters. The Act originally required the Commissioner to undertake regulation in accordance with several principles, including placing priority on the financial sustainability of ferry operators, encouraging ferry operators to adopt a commercial approach to ferry service delivery and moving over time to a greater reliance on a user pay system. Subsequently, the Act was amended as discussed below.

BILL 20

On June 24, 2010, the Province enacted *Miscellaneous Statutes Amendment Act (No. 3), 2010* (Bill 20), amending several statutes including the Act. The amendments responded to the Comptroller General's Report on Review of Transportation Governance Models released November 6, 2009 and included changes to the governance and regulatory framework within which we operate.

Among other things, Bill 20 amendments to the Act changed the mandate of the B.C. Ferry Authority (the Authority) to include responsibility for the compensation plans of our directors and certain executive officers, such compensation plans to be comparable to public sector organizations; a requirement that effective September 30, 2010, a director of the Authority cannot also be a director of BC Ferries; and, the subjection of the records of the Authority and BC Ferries to the *Freedom of Information and Protection of Privacy Act*.

The amendments also expanded the regulatory responsibilities of the Commissioner to include: consideration of the interests of ferry users; regulation of our reservation fees; approval and public disclosure of our process for handling customer complaints; and review and public disclosure of our ten year capital plan, our plan for improving efficiency in the next performance term, and our methodology for allocating costs among the regulated routes. These amendments also broadened the Commissioner's role in regulating ferry transportation services where the Commissioner determines that we have an unfair competitive advantage. The amendments have also modified the process by which the Commissioner regulates our activities in seeking additional or alternative service providers on our regulated routes and require the Commissioner to issue an opinion on our performance and that of the Authority in carrying out our respective legislated responsibilities, as well as our performance in relation to the CFSC.

PT2 PRICE CAP INCREASE

On April 1, 2011, the final year of PT2, the price cap authorized by the Commissioner increased by 2.7% plus 0.49 times the latest reported annual change in the CPI (British Columbia) on the three Major Routes connecting Greater Vancouver with mid and southern Vancouver Island and 5.7% plus 0.73 times the change in the CPI (British Columbia) on all other routes. This translated into a price cap increase of 3.38% on those three Major Routes and 6.71% on all other routes. These price cap increases reflected a change in the CPI (British Columbia) of 1.39% applied April 1, 2011.

PT3 PRELIMINARY PRICE CAP INCREASES

In March 2011, the Commissioner set preliminary price cap increases for each of the four years of PT3 of 4.15% on the three Major Routes and 8.23% on all other routes, effective April 1, 2012. In making these determinations, the Commissioner excluded certain forecasted costs and incorporated a productivity challenge effectively further reducing our allowed costs.

BILL 14

On June 2, 2011, the *Coastal Ferry Amendment Act, 2011* (Bill 14) was enacted. Effective April 1, 2012, for the first year of PT3, Bill 14 established a price cap increase for each route group of 4.15% from the weighted average of the tariffs in place at March 31, 2012 as established by the Commissioner. The Province agreed to make us whole for the resulting change in the price cap from what the Commissioner originally determined in his preliminary price cap order. The value of this price cap change was $11.5 million, which the Province agreed to provide as part of the $21.5 million increase in transportation fees for fiscal 2013 detailed below. In response to the price cap increases, we implemented tariff increases up to the new levels authorized. Bill 14 also provided that the Commissioner establish price caps for the balance of PT3.

Bill 14 also provided the Commissioner with the mandate to conduct a review of the Act before issuance of his final decision on price caps for the balance of PT3.

COMMISSIONER'S REVIEW OF THE ACT

On January 24, 2012, the Commissioner issued his report to the Province as to how the Act could be amended to balance the interests of ferry users with the financial sustainability of our company.

The report states:

Amongst the publicly-owned [ferry] systems, BC Ferries appears to be relatively efficient based on the analysis. Indeed, many ferry operators appear to want to emulate some of BC Ferries' practices. The Company compares well with farebox recovery and ancillary revenue. Costs appear to be reasonable based on a number of independent reviews and on substantial improvement in several areas since 2003.

The Commissioner's report made 24 substantive recommendations covering a wide range of ferry related issues and is available on the Commissioner's website at www.bcferrycommission.com.

BILL 47

In May 2012 and in response to the Commissioner's report, the Province enacted Bill 47. The amendments were designed to move toward striking a balance among the interests of ferry users, the interests of taxpayers and the sustainability of the ferry operator. The changes cover a wide range of ferry related issues including:

- Allowing cross subsidization from the Major Routes to other routes;
- Changing the primary responsibility of the Commissioner from priority placed on the financial sustainability of the ferry operations to responsibility to protect the interests of ferry users, the interests of taxpayers, and the financial sustainability of the ferry operator;
- Expanding the Commissioner's authority and responsibilities, to include:
  - The authority to permanently reduce service in a manner and to a level consistent with the CFSC;
  - The authority to order a temporary or permanent service reduction and/or deferral of a planned capital expenditure in response to an extraordinary situation, in addition to or instead of an approval of extraordinary price cap increases;
  - The ability to require us to seek the Commissioner's approval in advance of making certain capital expenditures;
  - The responsibility to set price caps sufficient to enable us to meet our debt obligations and maintain access to borrowing rates that in the opinion of the Commissioner are reasonable;
  - Specific legislative authority to establish the deferred fuel cost accounts and the terms and conditions for their use, including fuel surcharges or rebates; and
  - The authority to conduct routine performance reviews and to require us to review our policies and undertake public consultation.

FERRY TRANSPORTATION FEES

Together with the introduction of amendments to the Act, the Province announced additional payments totalling $79.5 million in order to reduce the pressure for future fare and price cap increases. The first payment of $25.0 million, approved on March 30, 2012, was received April 20, 2012, as a contribution to our equity. A further $54.5 million will be received as follows: $21.5 million in fiscal 2013 (which includes $11.5 million as compensation for price cap adjustments as detailed above); $10.5 million in fiscal 2014; $11.0 million in fiscal 2015, and $11.5 million in fiscal 2016.

PUBLIC CONSULTATION

In addition, in May 2012, the Province announced that it would conduct public consultation with ferry dependent communities about adjustments to service levels and trade-offs between service adjustments, fare increases and potential community contributions. The Province also announced that it would seek public input to develop strategies to support a long-term vision for connecting coastal communities. This process concluded on December 21, 2012 and on March 5, 2013, the Province released its report summarizing the input it received during this consultation and engagement process. We provided technical assistance and subject matter support throughout this process. The Province's report can be found at www.coastalferriesengagement.ca.

CFSC AMENDMENTS

During the first quarter, amendments to the CFSC were agreed to with the Province. These amendments, effective April 1, 2012, included:

- Grouping our route connecting Horseshoe Bay and Langdale with the three Major Routes connecting Greater Vancouver with mid and southern Vancouver Island;
- A reduction of up to 400 round trips in the minimum service requirement on our Major Routes as well as principles and targets for further service level reductions system wide.
- Implementation of principle-based service adjustments to achieve $30 million in net savings over PT3. These are detailed below and included:
  - Reductions in round trips already identified on three of our Major Routes reflecting a net savings of $4 million; and

- Service adjustments to be determined on regulated routes to achieve an additional $26 million in net savings over PT3;

- An amending CFSC agreement was to be in place by June 30, 2013, specifying the $26 million in service adjustments. If the service level amending agreement is not in place by the stipulated date, the Province agreed that the circumstances would support us applying to the Commissioner for relief, and

- Ferry transportation fee enhancements of $54.5 million through PT3 as detailed above.

In response to the agreed reduction in the minimum service requirement on our Major Routes identified above, we implemented reductions in round trips on three of our Major Routes where the traffic levels no longer warranted extra service or where service was significantly under-utilized. Over PT3, these reductions are expected to result in $4 million in operating cost reductions from fuel savings and reduced requirements for casual employees during the off-season. There will be no reduction in our regular workforce. These identified reductions equate to 1% of our annual round trips on these routes. Further adjustments to service levels, as identified above, are required in order to attain the total objective of $30 million in net savings and these adjustments are expected to result from the Province's consultation process discussed above.

On March 31, 2013 we reached an agreement with the Province, amending the CFSC, to consolidate all regulated routes into a single group effective April 1, 2013. This revised grouping will be in effect until March 31, 2016. In the absence of any further amendments, on April 1, 2016, the route group structure in the CFSC will revert back to the structure at March 31, 2013.

On April 3, 2013, an amendment to the CFSC was agreed to with the Province. This amendment extended the deadline for identifying service level adjustments for the remainder of PT3 in order to provide sufficient time to the Province for further consultation with stakeholders regarding future service changes. The Province also agreed to pay us $7.1 million in ferry transportation fees. Specific service level adjustments to core service levels designed to achieve a further $18.9 million in net savings over the remainder of the performance term will be determined by March 31, 2014.

COMMISSIONER'S ORDERS

On September 30, 2012, the Commissioner issued Order 12-02 which established the following price cap increases for each route group: 4.1% at April 1, 2013; 4.0% at April 1, 2014; and 3.9% at April 1, 2015.

The order states "...the commissioner has established price caps with the intention of allowing the ferry operator to achieve by the end of the third performance term equity not lower than 17.5 per cent of total capitalization and a Debt Service Coverage Ratio ("DSCR") of 2.5 or higher."

In addition, the Commissioner reset the price caps for each route group to an index level of 100 as of April 1, 2012 based on the weighted average tariffs that existed as of March 31, 2012. The established price caps incorporate efficiency targets of $54.2 million, over and above the benefits associated with the service level adjustments, to be achieved by us over the four years of performance term three.

In his order, the Commissioner stated "The price caps have been determined based on the expectation that the CFSC will be amended by June 30, 2013 to implement service level adjustments to achieve net savings of $30 million during PT3. If the CFSC is not amended by June 30, 2013, or the amendments will not enable BC Ferries to achieve the target of $30 million in net savings, BC Ferries may apply for relief under section 42 of the Act."

On April 15, 2013, the Commissioner issued Order 12-02A, reducing the service level adjustments to achieve a total of $22.9 million in net savings during the remainder of PT3, to reflect the $7.1 million received from the Province. He also acknowledged the reduction of $4 million in service reductions already implemented with $18.9 million yet to be identified. The Commissioner also reconfirmed that we may apply for relief under section 42 of the Act if amendments made will not enable us to achieve the $22.9 million in net savings.

On September 30, 2012, the Commissioner issued Order 12-03 establishing the terms and conditions for the continued use of fuel price deferral accounts including the per litre cost of fuel included in the determination of price caps (the set price) for PT3. This was in response to our application filed in June 2012 seeking approval to establish a new fuel cost deferral mechanism under section 41.1 of the amended Act. On February 28, 2013, Order 12-03A was issued to extend the submission date for annual fuel reports to no later than 90 days after the end of the fiscal year.

On September 30, 2012, the Commissioner also issued Order 12-04 establishing the criteria for determining major capital expenditures which require advance approval from the Commissioner.

The Commissioner's orders can be viewed at www.bcferrycommission.com.

THE EFFECT OF RATE REGULATION

We are regulated by the Commissioner to ensure, among other things, that our tariffs are fair and reasonable. Under the terms of the Act, the tariffs we charge our customers over a performance term are subject to price caps set by the Commissioner. The Commissioner may, under certain circumstances, allow increases in price caps over the set levels. Certain decisions and orders of the Commissioner may give rise to assets or liabilities. Regulatory assets generally represent incurred costs that are probable of future recovery in tariffs or fuel surcharges. Regulatory liabilities represent obligations to customers which will be settled through future tariff reductions or fuel rebates.

IFRS differs significantly from previous accounting standards. IFRS does not have a standard for rate-regulated activities and, therefore, does not permit us to report in our financial statements, the assets and liabilities that result from the regulated price cap setting process, such as our deferred fuel cost accounts. Rather than being charged to regulatory asset accounts on our Statements of Financial Position, fuel surcharges collected or rebates granted are now included in revenue, and increases or decreases in fuel prices from those approved in price caps are now included in operating expenses. While this is a significant accounting change for us, it does not change the treatment of these types of assets and liabilities for regulatory purposes.

We continually assess whether our regulatory assets are probable of future recovery by considering such factors as applicable regulatory changes and we believe the regulatory assets at March 31, 2013 are probable of future recovery and that the obligations as represented by the regulatory liabilities will be settled through future tariff reductions. These regulatory assets and regulatory liabilities are detailed in note 21 to our audited consolidated financial statements.

If IFRS permitted us to report regulatory assets and liabilities in our financial statements, the effect on our Statements of Comprehensive (Loss) Income for the quarter and year ended March 31, 2013 and 2012 would be as follows:

		Three months ended March 31		Year ended March 31	
($ millions)		**2013**	**2012**	**2013**	**2012**
Total comprehensive (loss) income		**(36.0)**	(39.9)	**16.6**	(6.8)
Regulatory asset or liability	**Statement line item**				
Deferred fuel costs[a]					
Fuel costs incurred	Operations expense	**3.0**	5.1	**11.3**	19.4
Fuel surcharges collected	Fuel surcharge revenue	**–**	(4.2)	**(11.5)**	(13.1)
Payments from the Province	Ferry transportation fees	**(0.9)**	(0.7)	**(2.5)**	(3.3)
Amortization of first performance term accounts	Amortization expense	**–**	(1.0)	**–**	(4.6)
		2.1	(0.8)	**(2.7)**	(1.6)
Tariffs in excess of price cap[b]					
Obligation settled during the period	Tariff revenue	**–**	(2.5)	**2.5**	(1.4)
Performance term submission costs[c]	Administration expense	**–**	–	**–**	0.1
	Amortization expense	**–**	(0.1)	**(0.1)**	(0.1)
Increase (decrease) in total comprehensive income		**2.1**	(3.4)	**(0.3)**	(3.0)
Adjusted total comprehensive (loss) income		**(33.9)**	(43.3)	**16.3**	(9.8)

(a) Deferred fuel costs: As prescribed by regulatory order, we defer differences between actual fuel costs and approved fuel costs which were used to develop the regulated price caps. The difference between the approved fuel costs and the actual fuel costs (including fuel hedge gains and losses) is deferred for settlement in future tariffs. Also, as prescribed by regulatory order, we collect fuel surcharges or provide fuel rebates from time to time which are applied against deferred fuel cost account balances.

(b) Tariffs in excess of price cap: The Act contains provisions which ensure that if tariffs that we charge exceed established price caps, the excess amounts collected will be returned to customers through future tariffs.

(c) Performance term submission costs: Costs for incremental contracted services relating to PT3. Our regulator has approved recovery of these costs over PT3.

Financial and Operational Overview

As of April 1, 2012, we are reporting our financial position and financial performance under IFRS. We are presenting fiscal 2012 under both IFRS (for comparison with fiscal 2013) and under CGAAP (for comparison with fiscal 2011).

This section provides an overview of our financial and operational performance for the past three fiscal years.

Years ended March 31 ($ millions)	2013 *IFRS*	2012 *IFRS*	2012 *CGAAP*	2011 *CGAAP*
Total revenue	**786.4**	753.8	738.2	739.3
% increase (decrease)	***4.3%***	*n/a*	*(0.1%)*	*1.0%*
Operating expenses	**701.6**	693.0	682.7	672.2
Operating profit	**84.8**	60.8	55.5	67.1
Net finance and other	**69.3**	69.8	72.0	63.3
Net earnings (loss)	**15.5**	(9.0)	(16.5)	3.8
Other comprehensive income	**1.1**	2.2	–	–
Total comprehensive income (loss)	**16.6**	(6.8)	(16.5)	3.8

As at March 31	2013	2012	2012	2011
Total assets	**1,824.3**	1,836.7	1,819.5	1,857.6
Total long-term financial liabilities	**1,199.8**	1,349.6	1,343.4	1,387.2
Dividends on preferred shares	**6.0**	6.0	6.0	6.0

Our IFRS comprehensive income in fiscal 2013 was $23.4 million higher and net earnings were $24.5 million higher than in fiscal 2012. Fiscal 2013 net earnings reflect the effects of increased fares and higher ferry transportation fees, partially offset by lower traffic levels, while maintaining our cost containing initiatives. Our CGAAP earnings in fiscal 2012 were $20.3 million lower than in fiscal 2011. Fiscal 2012 net earnings reflect the effects of lower than expected traffic levels and an $8.5 million increase in amortization expense. Fiscal 2011 results included a $9.3 million gain on sale of our former corporate office building.

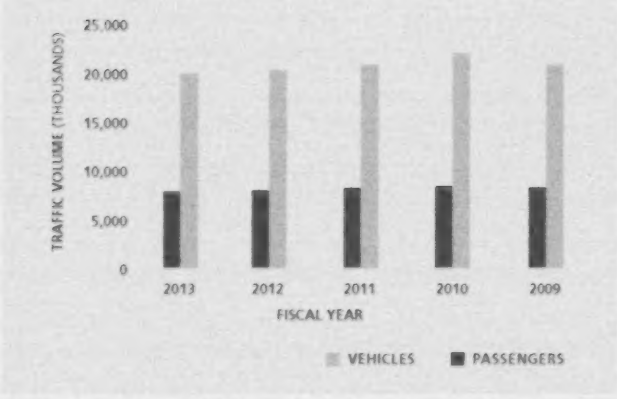
TRAFFIC

Our traffic levels historically were relatively stable. However, the long-term traffic trend-line shifted significantly during fiscal 2009, when vehicle and passenger traffic were lower than the prior year by 5.2% and 4.9%, respectively. In fiscal 2009, the Canadian and world economies experienced turbulence in the financial markets, followed by a lengthy recessionary period. These declining economic conditions negatively impacted our commercial and discretionary travel markets.

In the following four fiscal years 2010 through 2013, we experienced an overall general decline in traffic reflecting a continued worldwide economic downturn, reduced levels of tourism, and fluctuations in fuel prices.

In fiscal 2013, we experienced a 1.1% decline in vehicle traffic and a 1.2% decline in passenger traffic. A significant factor in the decline was a period of stormy weather with high winds that resulted in numerous sailing cancellations during the December holiday season. In three of the last five months of fiscal 2013, our total traffic was higher than the same periods in the prior year. Increases of 2.9% in vehicle traffic and 3.0% in passenger traffic on our Major Routes were experienced in the last quarter of fiscal 2013. Every category of traffic was higher with the exception of buses.

The following graph illustrates our annual vehicle and passenger traffic levels from fiscal 2009 through fiscal 2013.



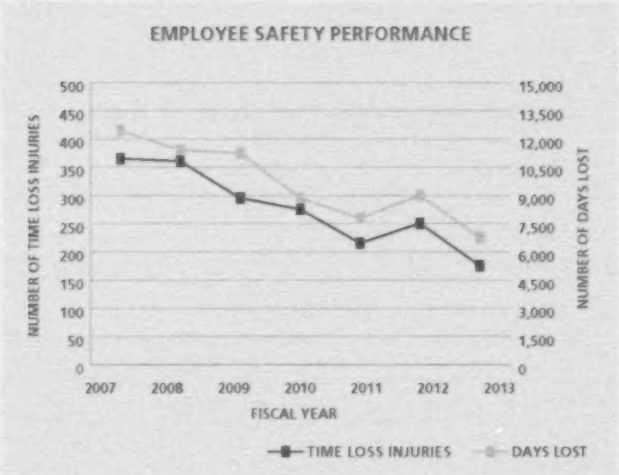
COST CONTAINMENT

In response to the decline in traffic levels and resulting revenues that began in fiscal 2009, we determined the need to restructure our business to align expenses with reduced revenues while continuing to ensure that safety remains our top priority. We carried out this restructuring in addition to deferral of filling staff vacancies and a hiring freeze for all non-essential positions, a two-year wage and salary freeze for exempt employees, reduced use of outside contractors and consultants, and reduction of discretionary expenditures. We continue to manage our costs as prudently as possible without compromising safe operations. Our operating expenses, excluding fuel costs, were $27.2 million below previously planned levels as published in our annual Business Plan for fiscal 2013.

We also applied to the Province to reduce up to 400 round trips annually on our major routes. CFSC amendments were subsequently made to reduce up to 400 round trips in the minimum service requirement on our Major Routes, as well as establish principles and targets for further service level reductions to achieve a net savings system wide of $30 million over PT3. (See "Economic Regulatory Environment – CFSC Amendments" above for more detail.)

SAFETY AND SECURITY

Overall, injuries to employees and passengers continue to decline and we are experiencing the real benefits of our investments in safety and security. In the past year, overall employee injuries declined by 13% and time loss injuries also declined by 13%. Since 2007, the number of time loss injuries we experienced each year has dropped from over 360 to just over 170. The number of days lost due to injury has declined from over 12,000 per year to under 7,000 per year. These results are illustrated in the graphic below:



In April 2012, our SailSafe program, which is designed to achieve world class safety performance, entered the sustainment phase. This phase marked the transition from the implementation of a safety program to embodying safety as a normal part of all business activities. At this point, no new action plans are introduced and safety becomes an integral part of our culture. The ultimate goal of SailSafe is for the program itself to no longer be necessary, as safety becomes completely ingrained in every activity undertaken, every day, throughout our business.

Specific areas of current focus include:

- Reinforcing the role of safety committees,
- Continuous improvement in the process to report a potential hazard or situation which could cause injury or harm to a person, damage to equipment, or damage to the environment. These reports are referred to as ALERTs, which is an acronym for "All Learning Events Reported Today";
- Building and maintaining awareness of safety through communication;
- Developing strong safety teams; and
- Monitoring action plans previously implemented.

As a testament to the effectiveness of SailSafe, by April 2013 approximately 4000 ALERTs had been submitted. This wealth of learning events has been fostered by a shift in safety culture, specifically to a "just culture", where employees are not punished for honest mistakes or errors in judgment, and instead learning is gleaned from all opportunities. This is designed to encourage employees to report an incident or near-miss that can serve as a learning experience throughout our operations.

The SailSafe town hall-style employee meetings conducted in fiscal 2013 were the most successful yet and were delivered to over 400 employees at various locations. A good mix of general information about our operations together with safety specific knowledge (presented in a case study format) was combined with feedback sessions. These sessions are an honest discussion about what is going well and what is not going so well regarding safety throughout our operations.

Fiscal 2013 saw excellent progress in a variety of key safety and security initiatives, including the successful implementation of an innovative process for managing operational risk that involves broad based employee training in risk awareness and risk management and the application of a new safety tool – an on line operational risk register.

Acknowledging that safety cannot be managed from behind a desk, we piloted a new approach to operational safety and resilience by conducting operational readiness exercises on seven vessels. Using realistic training scenarios, vessel teams were able to learn from mistakes without placing themselves or our physical assets at risk. The result was improved cross departmental coordination, higher morale and more confident vessel teams.

Overall, through a combination of continually pushing for change and introducing new and more sophisticated safety tools, we have seen a renewed vitality in our safety performance.

TRAINING

In fiscal 2013, 11,477 personal training days (PTDs) were conducted, inclusive of regulatory training, Bridge Team Simulation (BTS) training, and Standardized Education and Assessment (SEA) training. As the number of training programs continues to rise, we believe the level of employee engagement also increases. Since fiscal 2011, the number of employees

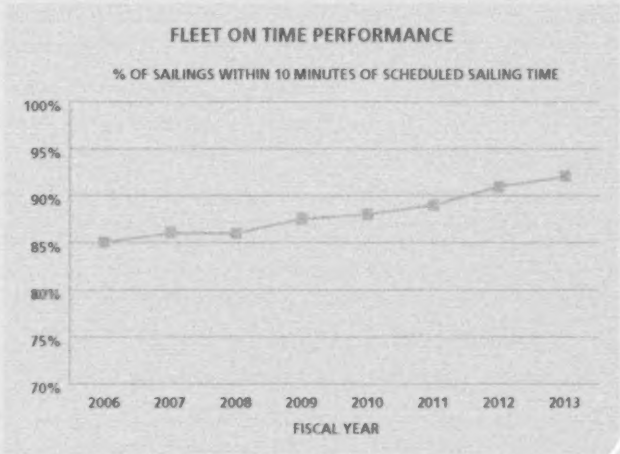
participating as trainers in the various programs has grown from 80 to 220, representing a 175% increase. Although PTDs were balanced over all of the 95 training programs, special focus was given to equipping front-line employees with requisite skills and knowledge to safely and effectively address both operational as well as customer-related issues. Specifically, 565 PTDs of Prevention of Violence in the Workplace training, 178 days of Musculoskeletal Injury Prevention training, and 720 days of Passenger Safety Management training were conducted. Our Life Saving Equipment (LSE) project, which includes a permanent training site at our fleet maintenance unit, was completed in fiscal 2013. The LSE site will host Restricted Proficiency in Survival Craft, Rescue/Shepherd Boat training, and Evacuation Training.

Our BTS training program is aimed at developing and enhancing bridge team skills and has continued to receive praise from those that have been through the training. Since beginning the training in October 2011, 75% of all deck officers in the fleet have completed the Bridge Operations Skills and Systems (BOSS) 1 courses. Building on BOSS 1 principles, the BTS instructors completed the formulation of a second course focusing on equipping individuals and teams with enhanced skills and knowledge, specifically with respect to gaining, maintaining and enhancing shared bridge team situational awareness. BOSS 2 includes a blended approach of simulation and classroom learning over three days and culminates in a team assessment to assist with students' learning transfer back to the fleet. Additional enhancements to the three BTS sites were made in fiscal 2013, including quartermaster stations and additional hydrodynamic models. These additions will ensure all bridge teams are receiving accurate representations of their operational vessels, thereby further ensuring engagement of the students and maximal learning transfer back to the fleet.

Our SEA program replaces the traditional job-shadowing approach to vessel and terminal familiarization training with a blended learning approach being delivered by dedicated SEA trainers. The program leverages technology and e-learning to enhance hands-on training in a phased, auditable and sustainable manner. This program is an innovative, award-winning approach that is transforming training in the marine industry through the use of technology. Fiscal 2013 focused on enhancements to existing positions already in place as well as the development and roll-out of several new programs. Since inception of the SEA project, 17 programs have been developed and rolled out and we continue to anticipate completing SEA development to April 2016, after which we will be fully shifted to enhancement and sustainment of the programs.

CUSTOMER SERVICE

In fiscal 2013, our on-time performance rate was 92.3% with a fleet reliability score of 99.8%. This reliability score means that only 0.2% of sailings in fiscal 2013 were cancelled due to mechanical issues related to the vessels or terminals or crew availability. Improvements in on-time departure rates and reliability scores over the past few years were reflected in the results of our 2012 Customer Service Satisfaction Tracking Surveys which indicated that 88% of customers surveyed reported being satisfied with their overall trip experience. This rating has remained stable from the 2011 results and is several points higher than the 82% rating received in 2003. Ratings remain high in all areas except for those relating to customer satisfaction with value received relative to the associated cost. A copy of the full report for each year is available on our website.



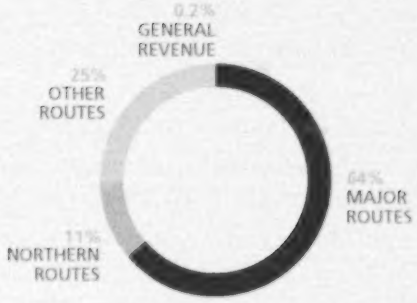
COLLECTIVE AGREEMENT

In February 2012, we reached an agreement with the BC Ferry & Marine Workers' Union (the Union) for a three year extension, to October 31, 2015, of the Collective Agreement which would have otherwise expired October 31, 2012. After two years of zero increases, a general pay increase of 1% was implemented on October 1, 2012 and a second general increase of 1.5% on April 1, 2013. There will also be a 2% increase in April of each of the last two years of the agreement. This extension to the Collective Agreement provides continued stability for our employees and uninterrupted ferry service for our customers.

Revenue

The following discussions of revenue are based on IFRS results with reference to the impacts of rate regulation. Results throughout reflect the amended CFSC which, effective April 1, 2012, includes the route connecting Horseshoe Bay and Langdale with the Major Routes and, as a consequence, this route has been removed from Other Routes and included in Major Routes in our discussions below for all years shown.

In fiscal 2013, the greatest portion of our revenues, 64%, was earned on our Major Routes. The revenue from the Northern Routes contributed 11% and Other Routes contributed 25%.



Total revenues and selected operational statistics over the past three fiscal years are shown in the tables below.

	2013	2012	2011
Operational Statistics			
Vehicle traffic	**7,748,743**	7,837,919	8,119,546
% increase(decrease)	**(1.1%)**	(3.5%)	(1.6%)
Passenger traffic	**19,919,098**	20,169,977	20,746,222
% increase(decrease)	**(1.2%)**	(2.8%)	(1.4%)
On-time performance	**92.3%**	91.6%	89.6%
Number of round trips	**84,114**	83,790	83,498
Capacity provided (AEQ's)	**17,607,012**	17,588,540	17,526,011
AEQ's carried	**8,769,217**	8,861,795	9,163,630
Capacity utilization	**49.8%**	50.4%	52.3%

In fiscal 2013, vehicle and passenger traffic decreased 1.1% and 1.2%, respectively, compared to fiscal 2012. The decline was experienced in both the Major and Other Routes while the Northern Routes experienced a modest increase. In three of the last five months, our total traffic was higher than the same period in the prior year. However, we experienced a significant reduction during the December holiday season primarily as a result of a period of stormy weather with high winds that resulted in numerous sailing cancellations. We continue to experience an increase in drop trailer traffic on two of our Major Routes where commercial customers can drop their trailers off at one terminal and pick them up at another.

On-time performance is defined as the percentage of our sailings departing within 10 minutes of the scheduled time on the Major and Other routes. The on-time performance on the Northern Routes is defined as the percentage of our sailings arriving within 10 minutes of the scheduled time. Meeting customer service expectations is an important factor in our focus on on-time performance.

The capacity provided, measured in automobile equivalents (AEQs), is the available space on the vessel times the number of round trips. Round trips normally stay fairly stable as the CFSC stipulates, among other things, the number of round trips to be provided for each regulated ferry service route. However, the number of round trips can be impacted by cancellations due to weather, vessel substitution, terminal dock closures and extra round trips made.

An AEQ is a standard unit of measure for an approximation of one car length. AEQs are calculated by using a conversion factor for each vehicle type. For example, a passenger vehicle would be one AEQ while a bus would be three AEQs.

Capacity utilization is calculated by taking the number of AEQs carried during the period divided by the AEQ capacity provided on the vessels. Capacity utilization is impacted by the number of vehicles carried, the mix of vehicle types (the relative number of buses, commercial vehicles, and passenger vehicles), the size of the vessels utilized; and the number of round trips in each period. The capacity utilization is lower this year compared to the prior year mainly as a result of a lower number of AEQs carried.

REVENUE

Years ended March 31 ($ millions)	2013 *IFRS*	2012 *IFRS*	2012 *CGAAP*	2011 *CGAAP*
Direct Route Revenue				
Vehicle tariff	**291.1**	283.7	282.8	284.6
Passenger tariff	**177.7**	174.7	174.2	173.5
Fuel surcharges	**11.5**	13.1	n/a	n/a
Catering & on-board	**74.5**	74.3	75.0	77.3
Social program fees	**28.6**	26.6	26.6	24.0
Reservation fees	**12.8**	13.8	13.8	15.6
Other revenue	**7.1**	6.9	6.3	6.6
Total Direct Route Revenue	**603.3**	593.1	578.7	581.6
Indirect Route Revenue				
Ferry transportation fees	**153.5**	131.7	128.3	127.0
Federal-Provincial subsidy	**28.1**	27.5	27.5	26.9
Total Route Revenue	**784.9**	752.3	734.5	735.5
Other general revenue	**1.5**	1.5	3.7	3.8
Total Revenue	**786.4**	753.8	738.2	739.3

Our largest revenue source is vehicle and passenger tariffs. Effective April 1, 2012, for the first year of PT3, Bill 14 established a price cap increase for each route group of 4.15% from the weighted average of the tariffs in place at March 31, 2012. In response to the changes, we implemented average tariff increases up to the new price cap levels authorized. On September 30, 2012, the Commissioner released the final price caps for the remaining three years of PT3, April 1, 2013 to March 31, 2016. (See "Corporate Structure – Economic Regulatory Environment" above for more detail.)

On November 30, 2012, as a result of declining fuel prices, all fuel surcharges were removed from our routes. Surcharges of 2.0% of tariffs on average had been in place on most of our regulated routes since July 20, 2012. These surcharges had been decreased from those previously in place of 2.5% on our Horseshoe Bay – Langdale route and 5.0% on most of our other routes. No surcharges or rebates were in place on our Northern Routes.

From time to time, we utilize promotional fares designed to stimulate growth in traffic or direct traffic towards our less busy sailings while ensuring compliance with approved price cap orders. In calculating the price cap, vehicle and passenger tariffs, as well as reservation fees, are combined. The utilization of promotional fare incentives and the effects of being over or under the price cap may cause the average vehicle and passenger tariff rate to be under or over the allowed increase in any one period.

Year to year changes for the past two fiscal years for the Major, Northern and Other Routes are discussed separately below.

YEAR TO YEAR COMPARISON OF IFRS REVENUES AND OPERATIONAL STATISTICS 2013 – 2012

Major Routes

Our Major Routes consist of three regulated routes connecting Greater Vancouver with mid and southern Vancouver Island and our regulated route connecting Horseshoe Bay and Langdale. These are our four busiest routes, carrying more than 59% of our vehicle traffic and 64% of our passenger traffic during both fiscal 2013 and 2012.

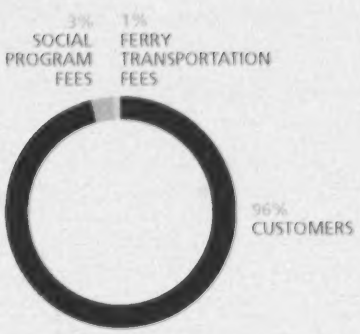
	2013	2012*	2011*
Operational Statistics			
Vehicle traffic	**4,600,647**	4,637,931	4,811,003
% increase(decrease)	**(0.8%)**	(3.6%)	(1.0%)
Passenger traffic	**12,777,222**	12,920,807	13,309,725
% increase(decrease)	**(1.1%)**	(2.9%)	(0.6%)
On-time performance	**84.5%**	86.5%	83.6%
Number of round trips	**12,621**	12,705	12,711
Capacity provided (AEQ's)	**9,053,830**	9,106,524	9,068,460
AEQ's carried	**5,411,460**	5,444,580	5,633,140
Capacity utilization	**59.8%**	59.8%	62.1%

*Restated to include our route connecting Horseshoe Bay and Langdale

Vehicle traffic decreased 0.8% and passenger traffic decreased 1.1% in fiscal 2013 compared to fiscal 2012. Traffic was negatively impacted by a period of stormy weather with high winds that resulted in numerous sailing cancellations in and around the December 2012 holiday season. The general decline in vehicle traffic was partially offset by a 33.5% increase in drop trailer traffic on two of our Major Routes where commercial customers can drop their trailers off at one terminal and pick them up at another.

The capacity utilization on these routes is the same as the prior year mainly as a result of reduced capacity provided in the current year, which offset the lower number of AEQs carried.

Fiscal 2013 revenue from our Major Routes consisted of 96% from customers and 4% from the Province (3% social program fees and 1% ferry transportation fees in support of our route connecting Horseshoe Bay and Langdale).



Years ended March 31 ($ thousands)	2013 IFRS	2012* IFRS	Increase (Decrease)	
Direct Route Revenue				
Vehicle tariff	**241,893**	234,483	7,410	3.2%
Passenger tariff	**142,363**	139,666	2,697	1.9%
Fuel surcharges	**9,481**	9,768	(287)	(2.9%)
Catering & on-board	**67,240**	66,957	283	0.4%
Social program fees	**17,381**	16,124	1,257	7.8%
Reservation fees	**12,600**	13,499	(899)	(6.7%)
Parking	**3,714**	3,750	(36)	(1.0%)
Other revenue	**3,086**	2,943	143	4.9%
Total Direct Route Revenue	**497,758**	487,190	10,568	2.2%
Indirect Route Revenue				
Ferry transportation fees	**3,391**	3,965	(574)	(14.5%)
Federal-Provincial subsidy	**–**	986	(986)	(100.0%)
Total Route Revenue	**501,149**	492,141	9,008	1.8%

*Restated to include our route connecting Horseshoe Bay and Langdale.

Average tariff revenue per vehicle increased $2.02 or 4.0% compared to the prior year. Average tariff revenue per passenger increased $0.33 or 3.1%. Higher average fares more than offset the traffic decline, resulting in an increase in tariff revenue of $10.1 million.

Fuel surcharges collected were $0.3 million lower than the prior year. Surcharges were eliminated on November 30, 2012 as a result of declining fuel prices. Surcharges of 2.0% of tariffs on average had been in place since July 20, 2012. These surcharges had been decreased from 2.5% on our Horseshoe Bay – Langdale route and 5.0% on our three other Major Routes connecting Greater Vancouver with mid and southern Vancouver Island. These surcharges had been in place since December 12, 2011. For regulatory purposes, these amounts are applied to our deferred fuel cost accounts. (See "The Effect of Rate Regulation" above for more detail.)

All vessels that provide service on our Major Routes have a gift shop and options for food service. Catering and on-board sales increased marginally from the prior year, reflecting higher average sales per passenger mainly offset by lower passenger traffic levels. Sales of quality apparel continue to grow, increasing a total of 14.4%. Sales of magazines, comics and newspapers continue to decline following industry trend.

Social program fees are reimbursements from the Province of discounts provided on fares for BC seniors, students travelling to and from school, persons with disabilities and persons travelling under the Ministry of Health Travel Assistance Program (MTAP). These fees increased as a result of higher program usage and higher fares. The most significant increases are a $1.0 million or 5.6% increase in the number of seniors travelling and a $0.3 million or 2.7% increase in the number of individuals travelling with vehicles under the MTAP program.

Reservation fees decreased as a result of the lower traffic levels and lower usage. Revenue from parking remained at a similar level as the prior year.

Other revenue increased mainly as a result of an increase in hostling[1] fees from our drop trailer service. This service has been well received in the commercial market place.

Ferry transportation fees decreased $0.6 million. They include:

- Ferry transportation fees received in support of services provided on our Horseshoe Bay – Langdale route, resulting in a decrease of $1.4 million from the prior year. While total ferry transportation fees from the Province increased, a lower portion of the total fees has been allocated by the Province to support the Horseshoe Bay – Langdale route this fiscal year. (See "Corporate Structure – Economic Regulatory Environment" above for more detail.)

1 Loading and unloading of commercial trailers that are dropped off for transportation on a ferry route.

- A re-allocation of funds received from the Province related to the import duty remission on one of our foreign-built vessels, resulting in an increase of $0.8 million. For regulatory purposes, this amount is applied to our deferred fuel cost accounts. (See "The Effect of Rate Regulation" above for more detail.)

The allocation of the Federal-Provincial subsidy to the Horseshoe Bay – Langdale route was eliminated effective April 1, 2012, the beginning of the third performance term. These funds were reallocated to the Northern and Other Routes.

Northern Routes

Our Northern Routes consist of three regulated routes operating on the British Columbia coast north of Port Hardy on Vancouver Island.

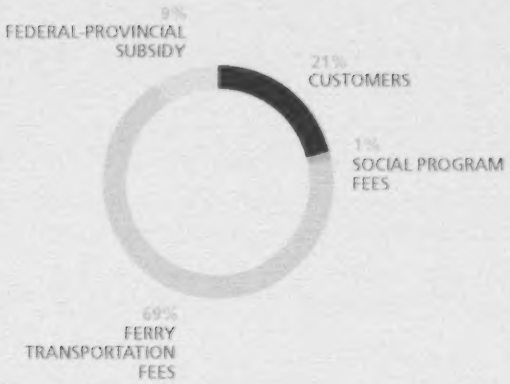
	2013	2012	2011
Operational Statistics			
Vehicle traffic	27,811	27,573	29,353
% increase(decrease)	0.9%	(6.1%)	(5.7%)
Passenger traffic	80,848	80,642	85,973
% increase(decrease)	0.3%	(6.2%)	(2.5%)
On-time performance	91.9%	90.6%	92.7%
Number of round trips	347	345	345
Capacity provided (AEQ's)	84,677	85,100	80,237
AEQ's carried	33,623	33,677	35,736
Capacity utilization	39.7%	39.6%	44.5%

In fiscal 2013, the Northern Routes experienced a modest increase in traffic. Vehicle traffic increased 0.9% and passenger traffic increased 0.3%, compared to the previous year.

The capacity utilization on these routes is marginally higher this year compared to the prior year mainly as a result of a small reduction in capacity provided in the current year.

Years ended March 31 ($ thousands)	2013 *IFRS*	2012 *IFRS*	Increase (Decrease)	
Direct Route Revenue				
Vehicle tariff	7,785	7,878	(93)	(1.2%)
Passenger tariff	6,917	7,075	(158)	(2.2%)
Social program fees	1,042	961	81	8.4%
Catering & on-board	2,007	2,108	(101)	(4.8%)
Stateroom rental	1,092	1,060	32	3.0%
Hostling & other	201	212	(11)	(5.2%)
Total Direct Route Revenue	19,044	19,294	(250)	(1.3%)
Indirect Route Revenue				
Ferry transportation fees	58,439	50,377	8,062	16.0%
Federal-Provincial subsidy	7,204	6,800	404	5.9%
Total Route Revenue	84,687	76,471	8,216	10.7%

Fiscal 2013 revenue from our Northern Routes consisted of 21% from customers and 79% from the Province (1% social program fees, 69% ferry transportation fees, and 9% from payments under the Federal-Provincial subsidy agreement).



The average tariff revenue per vehicle decreased $5.79 or 2.0% while the average tariff revenue per passenger decreased $2.18 or 2.5%, compared to the prior year, mainly as a result of a greater proportionate number of vehicles and passengers on the shorter routes with lower fares. These lower average tariff rates, partially offset by higher traffic levels, resulted in a total tariff revenue decrease of $0.3 million.

There were no fuel surcharges or rebates in place on our Northern Routes.

Reimbursements from the Province for social program fees increased primarily as a result of higher usage of MTAP and higher fares, partially offset by lower usage of other programs.

Revenue from catering and on-board services decreased as a result of a lower average spending per passenger, partially offset by a marginal increase in passenger traffic.

Stateroom rental increased due to higher usage and a marginal increase in passenger traffic.

Hostling and other revenues decreased overall. Reservation revenue decreased while hostling and parking revenue increased marginally.

Ferry transportation fees increased $8.0 million. They include:

- Ferry transportation fees for these routes received under the CFSC. These fees increased $8.8 million as a result of additional funding from the Province as well as a larger portion of the total fees allocated by the Province to these routes. (See "Corporate Structure – Economic Regulatory Environment" above.)
- Ferry transportation fees received from the Province related to the price of fuel. For regulatory purposes, these amounts are applied to our deferred fuel cost accounts (see "The Effect of Rate Regulation" above for more detail). As a result of changes in fuel prices, these amounts were $0.8 million lower year over year.

The Federal-Provincial subsidy has increased by the change in the annual Consumer Price Index (CPI) (Vancouver) and an increase in the allocation of the total subsidy to the Northern Routes.

Other Routes

Our Other Routes consist of 18 regulated routes and eight small unregulated routes primarily serving the northern and southern Gulf Islands and the Sunshine Coast. One of the regulated routes and all of the unregulated routes are operated under contract by alternative service providers. We receive fees from the Province for the provision of contracted services on these routes, which are included in the ferry transportation fees in the table below.

	2013	2012*	2011*
Operational Statistics			
Vehicle traffic	**3,120,285**	3,172,415	3,279,190
% increase(decrease)	**(1.6%)**	(3.3%)	(2.6%)
Passenger traffic	**7,061,028**	7,168,528	7,350,524
% increase(decrease)	**(1.5%)**	(2.5%)	(2.8%)
On-time performance	**93.6%**	92.4%	90.6%
Number of round trips	**71,146**	70,741	70,442
Capacity provided (AEQ's)	**8,468,505**	8,396,916	8,377,314
AEQ's carried	**3,324,134**	3,383,538	3,494,754
Capacity utilization	**39.3%**	40.3%	41.7%

*Restated to exclude our route connecting Horseshoe Bay and Langdale

Vehicle traffic decreased 1.6% and passenger traffic decreased 1.5%, compared to the prior year.

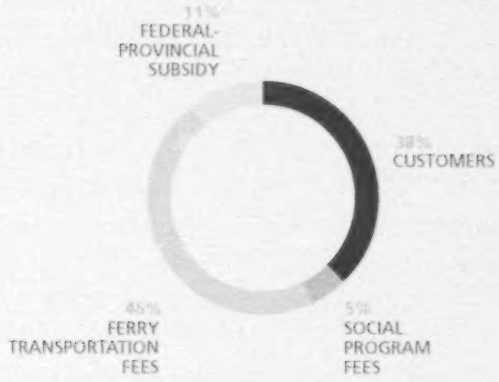
The capacity utilization on these routes is lower this year compared to the prior year mainly as a result of higher capacity provided (primarily due to fewer weather cancellations) and lower AEQs in the current year.

Years ended March 31 ($ thousands)	2013 *IFRS*	2012* *IFRS*	Increase (Decrease)	
Direct Route Revenue				
Vehicle tariff	**41,418**	41,323	95	0.2%
Passenger tariff	**28,404**	27,967	437	1.6%
Fuel surcharges	**1,988**	3,330	(1,342)	(40.3%)
Social program fees	**10,180**	9,522	658	6.9%
Catering & on-board	**4,153**	4,205	(52)	(1.2%)
Reservation fees	**208**	227	(19)	(8.4%)
Parking & other	**114**	92	22	23.9%
Total Direct Route Revenue	**86,465**	86,666	(201)	(0.2%)
Indirect Route Revenue				
Ferry transportation fees	**91,667**	77,311	14,356	18.6%
Federal-Provincial subsidy	**20,873**	19,702	1,171	5.9%
Total Route Revenue	**199,005**	183,679	15,326	8.3%

*Restated to exclude our route connecting Horseshoe Bay and Langdale

The average tariff revenue per vehicle increased $0.25 or 1.9%, compared to the prior year, while the average tariff revenue per passenger increased $0.12 or 3.1%. The increase in average fares, partially offset by the reduction in traffic, resulted in a total tariff revenue increase of $0.5 million.

Fiscal 2013 revenue from our Other Routes consisted of 38% from customers and 62% from the Province (5% social program fees, 46% ferry transportation fees, and 11% from payments under the Federal-Provincial subsidy agreement).



Fuel surcharges collected were $1.3 million lower than in the prior year. Surcharges were eliminated on November 30, 2012 as a result of declining fuel prices. Fuel surcharges on our regulated Other Routes were 2% of tariffs on average since July 20, 2012. Prior to July 20, 2012, fuel surcharges of 5% had been in place since June 1, 2011. For regulatory purposes, these amounts are applied to our deferred fuel cost accounts. (See "The Effect of Rate Regulation" above for more detail.)

Reimbursements from the Province for social program fees increased as a result of higher program usage and higher fares. The most significant increases were a $0.4 million or 7.4% increase in the number of seniors and a $0.2 million or 3.3% increase in the number of individuals travelling with vehicles under the MTAP program.

Decreases in revenue from catering and on-board services reflect the lower traffic levels on the routes where those services are offered and lower average spending per passenger.

Fees for reservations decreased as a result of lower usage and lower traffic levels.

Parking and other revenues are higher than the prior year, mainly due to an increase in usage of our parking facilities.

Ferry transportation fees increased $14.4 million. They include:

- Ferry transportation fees for the 18 regulated routes which increased $14.5 million as a result of additional funding from the Province as well as a larger portion of the total fees allocated by the Province to these routes. See "Corporate Structure – Economic Regulatory Environment" above.
- Fees from the Province for the provision of contracted service on unregulated routes which increased $0.7 million.
- Funds from the Province related to the import duty remission on one of our foreign-built vessels which were $0.8 million lower as a result of the reallocation among the routes. For regulatory purposes, these amounts are applied to our deferred fuel cost accounts. (See "The Effect of Rate Regulation" above for more detail.)

The Federal-Provincial subsidy has increased by the change in the annual CPI (Vancouver) and by an increase in the allocation of the total subsidy to the Other Routes.

YEAR TO YEAR COMPARISON OF CGAAP REVENUES 2012 – 2011

Major Routes

Years ended March 31 ($ thousands)	2012* CGAAP	2011* CGAAP	Increase (Decrease)	
Direct Route Revenue				
Vehicle tariff	233,619	234,844	(1,225)	(0.5%)
Passenger tariff	139,142	138,594	548	0.4%
Catering & on-board	67,565	69,883	(2,318)	(3.3%)
Social program fees	16,124	14,778	1,346	9.1%
Reservation fees	13,499	15,362	(1,863)	(12.1%)
Parking	3,750	3,853	(103)	(2.7%)
Other revenue	2,334	2,207	127	5.8%
Total Direct Route Revenue	476,033	479,521	(3,488)	(0.7%)
Indirect Route Revenue				
Ferry transportation fees	3,665	3,665	–	–
Federal-Provincial subsidy	986	966	20	2.1%
Total Route Revenue	480,684	484,152	(3,468)	(0.7%)

* Restated to include our route connecting Horseshoe Bay and Langdale.

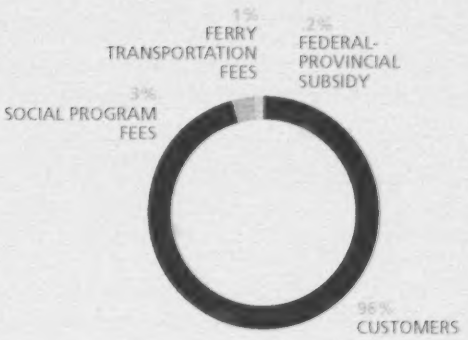
Vehicle traffic decreased 3.6% and passenger traffic decreased 2.9% in fiscal 2012 compared to fiscal 2011.

On June 2 through June 26, 2011, our "CoastSaver" program was in place on our three Major Routes connecting Greater Vancouver with mid and southern Vancouver Island. This promotional fare incentive program provided price discounts of more than 30% on passenger and passenger vehicle fares from Thursday through Sunday each week through the duration of the program. Despite this incentive program, traffic on these routes declined. This further reinforced our view that, while the level of ferry fares is a contributing factor, other external factors were primarily responsible for declining traffic levels.

The general decline in vehicle traffic was partially offset by a 54.5% or $2.4 million increase in drop trailer traffic on two of our Major Routes where commercial customers can drop their trailers off at one terminal and pick them up at another.

The decrease in traffic, partially offset by higher average fares, resulted in a total decrease of $0.7 million in tariff revenue.

Fiscal 2012 revenue from our Major Routes consisted of 96% from customers and 4% from the Province (3% social program fees and 1% ferry transportation fees in support of our route connecting Horseshoe Bay and Langdale).



Throughout the eight months ended November 30, 2010, fuel rebates of 2% of tariffs on average were in place on our three Major Routes connecting Greater Vancouver with mid and southern Vancouver Island. On December 1, 2010, the fuel rebates on all routes were removed due to the increasing cost of fuel. On June 1, 2011 fuel surcharges of 2.5% of tariffs on average were implemented on the three routes connecting Greater Vancouver with mid and southern Vancouver Island and subsequently increased to 5.0% on average effective December 12, 2011. On the Horseshoe Bay – Langdale Route, a fuel surcharge of 2.5% of tariffs on average was also implemented on December 12, 2011.

Social program fees increased as a result of higher program usage and higher fares.

Both food and gift shop sales decreased mainly as a result of lower passenger traffic. In our gift shops, sales of quality apparel remained strong, increasing $0.7 million or 14.8% from the prior year while, consistent with the industry trend, sales of books and magazines continued their decline.

The reduction in fees for reservations reflected lower usage and lower traffic levels. Parking revenue decreased mainly as a result of lower traffic levels.

Other revenue increased mainly as a result of an increase in hostling fees from our drop-trailer service for commercial customers.

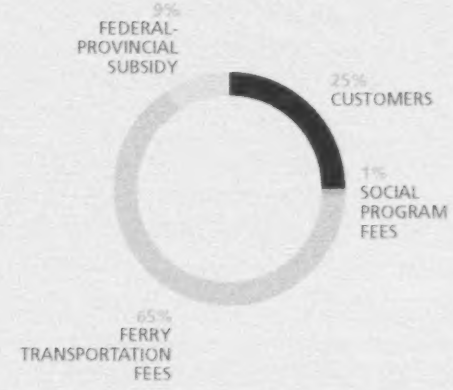
Ferry transportation fees and Federal-Provincial subsidy are received in support of services provided on our Horseshoe Bay – Langdale route.

The total Federal-Provincial subsidy increased by 2.1% reflecting the change in the annual CPI (Vancouver).

Northern Routes

Years ended March 31 ($ thousands)	2012 CGAAP	2011 CGAAP	Increase (Decrease)	
Direct Route Revenue				
Vehicle tariff	7,878	7,987	(109)	(1.4%)
Passenger tariff	7,075	7,349	(274)	(3.7%)
Catering & on-board	2,108	2,200	(92)	(4.2%)
Stateroom rental	1,061	1,008	53	5.3%
Social program fees	961	962	(1)	(0.1%)
Hostling & other	212	401	(189)	47.1%
Total Direct Route Revenue	19,295	19,907	(612)	(3.1%)
Indirect Route Revenue				
Ferry transportation fees	48,577	47,139	1,438	3.1%
Federal-Provincial subsidy	6,800	6,660	140	2.1%
Total Route Revenue	74,672	73,706	966	1.3%

Fiscal 2012 revenue from our Northern Routes consisted of 25% from customers and 75% from the Province (1% social program fees, 65% transportation fees, and 9% from payments under the Federal-Provincial subsidy agreement).



Both vehicle and passenger traffic decreased from fiscal 2011. The lower traffic levels, partially offset by higher average tariff rates, resulted in a total tariff revenue decrease of $0.4 million. There were no fuel surcharges or rebates in place on our Northern Routes.

Social program fees remained at a similar level to the prior year as a result of lower program usage mainly offset by higher fares.

Catering and on-board revenue decreased as a result of lower passenger traffic, partially offset by higher average spending per passenger. Although passenger traffic was lower, stateroom usage and rental fees increased.

The reduction in hostling and other revenue is mainly due to $178 thousand in charter fees received in fiscal 2011.

Ferry transportation fees were higher in fiscal 2012, reflecting an increase in funding related to the *Queen of Chilliwack* life extension, partially offset by the impact of lower net book value of the vessels used on these routes. The transportation fees decrease as the vessel assets are amortized.

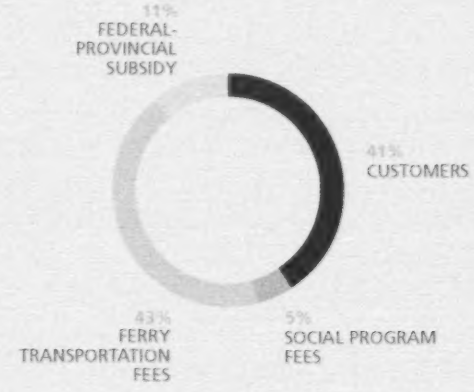
The total Federal-Provincial subsidy increased by 2.1% reflecting the change in the annual CPI (Vancouver).

Other Routes

Years ended March 31 ($ thousands)	2012* CGAAP	2011* CGAAP	Increase (Decrease)	
Direct Route Revenue				
Vehicle tariff	41,323	41,689	(366)	(0.9%)
Passenger tariff	27,969	27,586	383	1.4%
Social program fees	9,523	8,278	1,245	15.0%
Catering & on-board	4,205	4,236	(31)	(0.7%)
Reservation fees	226	232	(6)	(2.6%)
Parking & other	92	119	(27)	(22.7%)
Total Direct Route Revenue	83,338	82,140	1,198	1.5%
Indirect Route Revenue				
Ferry transportation fees	76,108	76,201	(93)	(0.1%)
Federal-Provincial subsidy	19,701	19,298	403	2.1%
Total Route Revenue	179,147	177,639	1,508	0.8%

*Restated to exclude our route connecting Horseshoe Bay and Langdale.

Fiscal 2012 revenue from our Other Routes consisted of 41% from customers and 59% from the Province (5% social program fees, 43% ferry transportation fees, and 11% from payments under the Federal-Provincial subsidy agreement).



Both vehicle and passenger traffic decreased from the prior year. The increased average fares were primarily offset by the decrease in traffic, resulting in total tariff revenue at the same level as the prior year.

Fuel surcharges of 5% were implemented on the majority of the Other Routes on June 1, 2011 due to the rising cost of fuel.

Reimbursements from the Province for social program fees increased as a result of higher fares and higher program usage.

Revenue from catering and on-board services decreased as a result of lower passenger traffic on the routes that provide catering services, partially offset by higher average spending per passenger.

Fees for reservations decreased primarily as a result of lower traffic levels.

Ferry transportation fees were at the same level as the prior year while the Federal-Provincial subsidy increased by 2.1% reflecting the change in the annual CPI (Vancouver).

Expenses

Expenses for the past three fiscal years are summarized in the tables below:

Years ended March 31 ($ millions)	2013 *IFRS*	2012 *IFRS*	2012 *CGAAP*	2011 *CGAAP*
Operating expenses				
Operations	436.8	433.2	413.3	411.1
Maintenance	70.0	65.9	86.3	85.7
Administration	29.6	31.2	31.0	31.2
Total operations, maintenance & administration	536.4	530.3	530.6	528.0
% increase	*1.2%*	–	*0.5%*	*2.6%*
Cost of retail goods sold	29.5	29.1	29.1	29.7
Depreciation and amortization	135.7	133.6	123.0	114.5
Total operating expenses	701.6	693.0	682.7	672.2

We continue to take proactive measures to contain and reduce expenses while continuing to ensure that safety has remained our top priority. Our operating expenses, excluding fuel costs, were $27.2 million below previously planned levels as published in our annual Business Plan for fiscal 2013.

Years ended March 31 ($ millions)	2013 *IFRS*	2012 *IFRS*	2012 *CGAAP*	2011 *CGAAP*
Net finance and other				
Interest expense				
Bond interest	63.3	63.4	63.4	63.3
KfW bank group (KfW) loans	8.3	9.4	9.4	10.5
Interest on finance lease	2.3	2.4	2.4	1.2
Short-term debt	0.4	0.2	0.2	0.2
Interest on deferred accounts	n/a	n/a	–	0.3
Structured Financing Facility (SFF) program	(0.4)	(1.5)	(1.5)	(0.5)
Capitalized interest	(1.8)	(2.0)	(2.0)	(2.9)
Total interest expense	72.1	71.9	71.9	72.1
Less: finance income	(2.9)	(2.4)	n/a	n/a
Net finance expense	69.2	69.5	n/a	n/a
(Gain) on foreign exchange	n/a	n/a	(0.2)	(0.2)
Loss (gain) on disposal of property, plant and equipment	0.1	0.3	0.3	(8.6)
Total net finance and other expenses	69.3	69.8	72.0	63.3

YEAR TO YEAR COMPARISON OF IFRS EXPENSES 2013 – 2012

The $3.6 million increase in fiscal 2013 operations expenses consists of:

- $5.0 million increase in wage and benefits costs mainly due to wage rate increases and higher benefit costs;
- $1.3 million increase in fuel expense reflecting an increase of $3.3 million or 1.1% due to higher fuel prices, partially offset by a $2.0 million or 1.7% decrease in fuel consumption. While IFRS does not permit accounting for rate-regulated entities, we are in fact rate-regulated. For purposes of rate regulation, $11.3 million of our fuel expense for fiscal 2013 ($19.4 million for fiscal 2012) is recorded in deferred fuel cost accounts for future recovery. (See "The Effect of Rate Regulation" above for more detail);

Partially offset by:

- $1.2 million decrease in materials, supplies and contracted services;
- $0.9 million decrease in insurance premiums and claims; and
- $0.6 million decrease in several other operational areas including rental and lease expenses, telecommunications costs, and advertising and public relations costs.

The $4.1 million increase in maintenance costs reflects an increase in vessel maintenance reflecting the variations in vessel refit scheduling and an increase in terminal maintenance.

The $1.6 million decrease in administration expenses is mainly due to lower wages and benefits, including lower executive compensation which is due to a reduced number of senior executive positions and a lower average compensation per executive position.

The $0.4 million increase in cost of retail goods sold reflects the increase in overall sales and a change in sales mix with a decrease in food sales with a lower cost and an increase in gift shop sales with a higher cost.

Depreciation and amortization increased $2.1 million reflecting higher amortization resulting from the new capital assets entering service during fiscal 2013. (See "Investing in our Capital Assets" below for details of capital asset expenditures in fiscal 2013.)

Net finance and other expenses decreased $0.5 million primarily due to:

- $1.1 million reduction in interest due to lower interest rates on the Tranche B than on the Tranche A components of the 12-year KfW loans and $9.0 million of principal repayments on the 2.95% KfW loan. (See "Liquidity and Capital Resources – Long-Term Debt" below for more detail);
- $0.5 million increase in finance income; and
- $0.2 million reduction in losses on disposal of property, plant and equipment;

Partially offset by:

- $1.1 million in lower interest rate support through the SFF program offered by the Government of Canada, reflecting the completion of the funding related to the life extension of the *Quinsam*; and
- $0.2 million less interest capitalized.

YEAR TO YEAR COMPARISON OF CGAAP EXPENSES 2012 – 2011

The $2.2 million increase in fiscal 2012 operations expenses consists of:

- $4.0 million or 4.1% increase in fuel expense as a result of higher fuel prices, partially offset by a 0.4% decrease in fuel consumption;

Partially offset by:

- $0.8 million reduction in advertising and public relations; and
- $1.0 million reduction in a number of miscellaneous items.

The $0.6 million increase in maintenance costs reflects an increase in vessel maintenance reflecting the variations in vessel refit scheduling, mainly offset by reductions in terminal maintenance. We completed 26 refits in fiscal 2012 and had one in progress at March 31, 2012.

Administration expenses remained at a similar level to the prior year.

Amortization increased $8.5 million reflecting higher amortization resulting from the new capital assets entering service during fiscal 2012.

Interest expenses decreased $0.2 million primarily due to:

- $1.0 million in higher interest rate support through the SFF program offered by the Government of Canada, reflecting the funding related to the life extension of the *Quadra Queen II*; and
- $1.1 million less interest due to principal repayments of $45 million on the 12-year amortizing KfW loans and $9 million on the 2.95% loan.

Partially offset by:

- $1.2 million increased interest on the capital lease of the new corporate office building reflecting a full year of the lease being in effect compared to a partial year in fiscal 2011; and
- $0.9 million less interest capitalized.

On November 1, 2010, our former corporate office building was sold for $11.0 million, resulting in a gain on sale of $9.3 million being recognized in fiscal 2011.

Liquidity and Capital Resources

LIQUIDITY AND CAPITAL RESOURCES

We fund our operations and capital acquisitions with cash flow generated from operations, as well as bank financing and debt issues.

In May 2012, the Province announced additional payments to us totalling $79.5 million in order to reduce the pressure for future fare and price cap increases. Of this, $25 million is a contribution to our equity and was received in April 2012. The remaining $54.5 million will be received over fiscal years 2013 through 2016.

Our capital expenditures are expected to increase over the next five years as we begin to replace aged minor and intermediate-sized vessels and make significant improvements at our terminals serving our Major Routes. In the near term, we expect our cash requirements will be met through operating cash flows and by accessing our credit facility from time to time. At March 31, 2013, our unrestricted cash and cash equivalents and other short-term investments totalled $37 million and $43 million, respectively.

We have two bond issues totalling $390 million that will mature within the next two years ($140 million in December 2013 and $250 million in May 2014). It is our intention to refinance these bonds and we will be monitoring the capital markets for appropriate opportunities, including the advisability of early redemption.

Our $155 million credit facility was amended on April 20, 2012 to extend the maturity date of the facility from May 2013 to April 2017, as well as to modify certain other terms of the facility. The credit facility was also amended on March 15, 2013, to further extend the maturity date to April 2018. The facility is available to fund capital expenditures and other general corporate purposes. At March 31, 2013, there were no draws on this credit facility.

We target maintaining a strong investment-grade credit rating to allow capital market access at reasonable interest rates. Our credit ratings at March 31, 2013, were "A" (DBRS) with a stable trend and "A+" (S&P) with a stable outlook. On February 14, 2013, we were advised by S&P that they affirmed our long-term rating of "A+" and revised our outlook from negative to stable, reflecting their view of an improvement in regulatory certainty. S&P also based their rating on their view of our "near-monopoly position, strong service area, moderately strong financial risk profile, and credit support provided from government fees for the service of non-profitable, smaller routes."

On September 30, 2012, the Commissioner issued Order 12-02 which established price cap increases for the balance of PT3. These price cap increases are sufficient to enable us to meet our debt obligations and maintain access to borrowing rates that, in the opinion of the Commissioner, are reasonable. The order indicated that the Commissioner had established the price caps with the intention of allowing us to achieve, by the end of PT3, equity not less than 17.5% of total capitalization and a DSCR of 2.5 or greater.

LONG-TERM DEBT

Our long-term debt is summarized below:

Amount outstanding as at March 31 ($ millions)	Effective interest rate	2013	2012	2011
Senior Secured Bonds				
5.74%, Due May 2014	5.92%	250	250	250
6.25%, Due October 2034	6.41%	250	250	250
5.02%, Due March 2037	5.06%	250	250	250
5.58%, Due January 2038	5.62%	200	200	200
6.21%, Due December 2013	6.33%	140	140	140
12 Year Loans				
Tranche A, Due March 2020	5.17%	53	60	68
Tranche B, Due March 2020	1.36%*	13	6	22
Tranche A, Due June 2020	5.18%	54	62	69
Tranche B, Due June 2020	1.35%*	13	5	21
2.95% Loan, Due January 2021	3.08%	72	81	90
		1,295	1,304	1,360

*Floating rate as at March 31, 2013

In 2004 we entered into the Master Trust Indenture (May 2004) (the MTI) available at www.SEDAR.com. This indenture established common security and a set of common covenants for the benefit of our lenders. Our financing plan encompasses an ongoing program capable of accommodating a variety of corporate debt instruments and borrowings ranking *pari passu*. We do not currently view common share equity as a potential source of capital and have no intention of offering common shares to the public or other investors.

We are also party to a credit agreement with a syndicate of Canadian banks that is secured under the MTI. Under this agreement, we have available a revolving facility in the amount of $155 million, maturing April 2018. The facility is available to fund capital expenditures and other general corporate purposes. At March 31, 2013, there were no draws on this credit facility ($17.7 million at March 31, 2012).

We have issued five senior secured bond offerings to date with interest payable semi-annually. The bonds are redeemable in whole or in part, at our option.

We have entered into three 12-year amortizing loan agreements with KfW, each of which is secured under the MTI. Two of these loans are at a fixed interest rate of 4.98%, payable quarterly. These agreements defer the principal payments for the first three years to a second tranche (Tranche B) on which interest is payable at a floating rate and the principal is due at maturity (March 2020 and June 2020). The third loan is at a fixed interest rate of 2.95%, payable semi-annually.

In fiscal 2011, we received $119.4 million of duty remission on our four foreign built vessels. The receipt of these funds provided us with additional financial flexibility and, as a result, in fiscal 2012, we paid down $45 million in debt consisting of the principal amounts outstanding on Tranche B of the two 12-year, 4.98% loans with KfW. These loan agreements were also amended to provide for the principal payments on these loans for the next three years being funded by draws on Tranche B, on which interest only is paid at a floating rate. The principal on Tranche B is due at maturity (March 2020 and June 2020).

TERMINAL LEASES

We entered into a master agreement with the BC Transportation Financing Authority (BCTFA) effective March 31, 2003, as part of the restructuring of our company. In return for the transfer of ownership interest in all ferry terminals from the former British Columbia Ferry Corporation to the BCTFA at the time of the corporate restructuring, we received recognition of prepayment of rent under terminal leases.

The leases grant us exclusive access and use of ferry terminal properties for a period of 60 years commencing April 1, 2003. The leases are renewable for an additional period of 20 years at a total cost of $20 per lease provided the CFSC is renewed. We must manage, maintain and develop the terminals at our own cost.

Since the original transfer, a total of $11.7 million of additional lands at Horseshoe Bay, Swartz Bay and Departure Bay have been added to the existing terminal leases in exchange for highway improvements.

If we fail to meet our obligations under the terminal leases or default under the CFSC, the BCTFA may at its option re-enter and take possession of the ferry terminal properties and at its option terminate the leases. The BCTFA has entered into an acknowledgement agreement with the Trustee under the MTI, which sets out certain limitations on the use of this option.

FINANCE LEASE

In September 2010, agreements which constitute a finance lease for space in our new corporate office building in downtown Victoria took effect following the completion of construction of the new building.

The initial term of the lease was 15 years, with four renewal options of five years each. In November, 2010, we advanced $24.2 million to the developer of the property for a term of 15 years, secured by a second mortgage on the property. The loan agreement provides for interest equal to one-half of the net cash flow from the property, subject to minimum and maximum percentage rates of interest. Over the term of the loan, interest is expected to approximate the market rate when the loan was made. Incidental to the loan, we were granted an option to purchase up to 50% of the owner's equity interest in the new building at a price of $24.2 million. Final adjustments were made on April 15, 2011, bringing the total amount of the loan and the purchase option to $24.5 million. The purchase option expires at the end of the loan term.

OTHER LONG-TERM LIABILITIES

Other long-term liabilities consist primarily of accrued post-retirement and post-employment benefits.

SOURCES & USES OF CASH

Our liquidity needs are met through a variety of sources, including cash generated from operations, issuance of bonds, and borrowings under our credit facility. Our primary uses of funds are operational expenses, capital asset acquisitions and upgrades, and payments on our long-term debt.

Sources and uses of cash and cash equivalents for fiscal 2013 and 2012 are summarized in the table below:

Years ended March 31 ($ millions)	2013	2012	Increase (decrease)
Cash and cash equivalents, beginning of year	7.7	33.3	(25.6)
Cash from operating activities:			
Net earnings (loss)	15.5	(9.0)	24.5
Items not affecting cash	208.0	205.2	2.8
Changes in non-cash operating working capital	1.6	(9.5)	11.1
Net interest paid	(70.5)	(71.2)	0.7
Cash generated by operating activities	154.6	115.5	39.1
Cash used in financing activities	(8.8)	(49.1)	40.3
Cash used in investing activities	(116.9)	(92.0)	(24.9)
Net increase (decrease) in cash and cash equivalents	28.9	(25.6)	54.5
Cash and cash equivalents, end of year	36.6	7.7	28.9

For the year ended March 31, 2013, cash generated by operating activities increased $39.1 million compared to the prior year mainly due to $24.5 million higher net earnings and $11.1 million resulting from changes in operating working capital.

Cash used in financing activities of $8.8 million in fiscal 2013 was mainly due to $9.0 million in debt repayments on KfW loans; $17.7 million in repayments of short-term debt; and $6.0 million in dividends paid on preferred shares; partly offset by the receipt of $25.0 million contributed surplus from the Province.

Cash used in financing activities of $49.1 million in fiscal 2012 was mainly due to $55.9 million in debt repayments on KfW loans; $6.0 million in dividends paid on preferred shares; less $13.8 million in proceeds from short-term debt.

Cash used in investing activities in fiscal 2013 was $24.9 million higher mainly due to a $53.7 million increase in cash used for short-term investing partially offset by a $29.8 million decrease in cash used for capital expenditures. In fiscal 2013, we purchased $16.5 million of short-term investments, compared to $37.2 million of proceeds received from short-term investments in the prior year. Cash used to purchase property, plant, equipment and intangible assets in fiscal 2013 totalled $100.6 million, compared to $130.4 million in the prior year. (See "Investing in Our Capital Assets" below for detail of significant capital expenditures.)

Fourth Quarter Results

The following provides an overview of our financial performance and selected operational statistics for the three months ended March 31, 2013, compared to the three months ended March 31, 2012.

The fourth quarter reflects a seasonal reduction in traffic levels which we utilize to perform upgrades and major maintenance and refit programs as well as to undertake mandatory inspections on the majority of our vessels.

	2013	2012	2011
Operational Statistics			
Vehicle traffic	**1,516,919**	1,502,231	1,555,687
% increase(decrease)	**1.0%**	(3.4%)	(2.1%)
Passenger traffic	**3,723,899**	3,666,163	3,744,938
% increase(decrease)	**1.6%**	(2.1%)	(5.3%)
On-time performance	**94.4%**	94.4%	95.4%
Number of round trips	**20,215**	20,273	20,038
Capacity provided (AEQ's)	**4,124,740**	4,080,430	4,048,676
AEQ's carried	**1,731,162**	1,716,673	1,770,570
Capacity utilization	**42.0%**	42.1%	43.7%

Vehicle traffic increased 1.0% and passenger traffic increased 1.6% in the fourth quarter, compared to the same quarter in fiscal 2012. On our Major Routes, vehicle traffic increased 2.9% and passenger traffic increased 3.0% in the fourth quarter. The increase was experienced in both the Major and Northern Routes while the Other Routes experienced a small decrease. In January and March we experienced increases in both vehicle and passenger traffic. In February, there was a decrease in both vehicle and passenger traffic. We believe that this decrease was primarily due to people choosing not to travel during the new Family Day statutory holiday. Traffic in March was higher than the same period in the prior year mainly due to the timing of the Easter holiday.

Three months ended March 31 ($ millions)	2013	2012	Variance $	Variance %
Total revenue	150.5	145.0	5.5	3.8%
Operating expenses	170.7	169.6	(1.1)	(0.6%)
Operating loss	(20.2)	(24.6)	4.4	17.9%
Net finance and other	16.9	17.5	0.6	3.4%
Net loss	(37.1)	(42.1)	5.0	11.9%
Gain on revaluation of land	1.1	2.2	(1.1)	(50.0%)
Total comprehensive loss	(36.0)	(39.9)	3.9	9.8%

Our IFRS total comprehensive loss in the three months ended March 31, 2013 was $3.9 million less and the net loss was $5.0 million less than in the same quarter of fiscal 2012. Fiscal 2013 net loss reflects the effects of increased fares, higher traffic levels and ferry transportation fees, partially offset by higher net operating expenses.

REVENUE

Our total revenues have increased as shown in the following table:

Three months ended March 31 ($ millions)	2013	2012	Increase (Decrease) $	Increase (Decrease) %
Direct Route Revenue				
Vehicle tariff	56.2	53.1	3.1	5.8%
Passenger tariff	32.0	30.4	1.6	5.3%
Fuel surcharges	–	4.2	(4.2)	(100.0%)
Catering & on-board	13.3	12.8	0.5	3.9%
Social program fees	6.0	5.7	0.3	5.3%
Reservation fees	1.8	2.2	(0.4)	(18.2%)
Other revenue	1.7	1.6	0.1	6.3%
Total Direct Route Revenue	111.0	110.0	1.0	0.9%
Indirect Route Revenue				
Ferry transportation fees	32.2	27.7	4.5	16.2%
Federal-Provincial subsidy	7.0	6.9	0.1	1.4%
Total Route Revenue	150.2	144.6	5.6	3.9%
Other general revenue	0.3	0.4	(0.1)	(25.0%)
Total Revenue	150.5	145.0	5.5	3.8%

Average tariff revenue per vehicle increased $1.70 or 4.8% in the quarter compared to the prior year and average tariff revenue per passenger increased $0.30 or 3.6%. The increase in traffic and the higher average fares resulted in an increase of $4.7 million in tariff revenue.

No fuel surcharges were in place in the fourth quarter of fiscal 2013. Surcharges of 2.5% on our Horseshoe Bay – Langdale route and 5.0% on most of our other routes were in place during the fourth quarter of fiscal 2012. No surcharges or rebates were in place on our Northern Routes during either year.

Catering and on-board revenues increased mainly as a result of higher passenger traffic.

Social program fees increased mainly as a result of a 6.7% increase in the number of seniors travelling on all of our routes and an increase in fares.

Reservation fees decreased as a result of lower usage.

The increase in other revenue is mainly due to increases in hostling revenue and stateroom rental.

Ferry transportation fees were higher primarily as a result of additional funding from the Province as described on page 40.

EXPENSES

Our operating and net finance and other expenses are shown in the following tables:

Three months ended March 31 ($ millions)	2013	2012	(Increase) Decrease $	(Increase) Decrease %
Operating expenses				
Operations	103.1	101.2	(1.9)	(1.9%)
Maintenance	20.4	19.2	(1.2)	(6.3%)
Administration	8.1	8.5	0.4	4.7%
Total operations, maintenance & administration	131.6	128.9	(2.7)	(2.1%)
Cost of retail goods sold	5.4	5.2	(0.2)	(3.8%)
Depreciation and amortization	33.7	35.5	1.8	5.1%
Total operating expenses	170.7	169.6	(1.1)	(0.6%)

The increase in operations costs, compared to the same period in the prior year, is mainly due to an increase in wages and benefits, partially offset by reductions in several areas, including fuel, contracted services, materials and supplies.

The increase in maintenance costs reflects variations in vessel refit scheduling.

Administration costs decreased mainly due to lower wages and benefits costs, including lower executive compensation which is due to a reduced number of senior executive positions and a lower average compensation per executive position.

Depreciation and amortization was lower in the quarter mainly due to adjustments in the prior year increasing the amortization of major spare parts.

Three months ended March 31 ($ millions)	2013	2012	(Increase) Decrease $	(Increase) Decrease %
Net finance and other				
Interest expense				
Bond interest	15.6	15.7	0.1	0.6%
KfW loans	2.0	2.2	0.2	9.1%
Interest on finance lease	0.6	0.6	–	–
Short-term debt	0.1	–	(0.1)	–
SFF program	–	(0.3)	(0.3)	–
Capitalized interest	(0.5)	(0.4)	0.1	25.0%
Total interest expense	17.8	17.8	–	–
Less: finance income	(0.9)	(0.6)	0.3	50.0%
Net finance expense	16.9	17.2	0.3	1.7%
Loss on disposal of property, plant and equipment	–	0.3	0.3	–
Total net finance and other expenses	16.9	17.5	0.6	3.4%

Net finance expenses in the quarter were $0.6 million lower compared to the same period in the prior year, primarily due to $0.3 million in higher finance income and $0.3 million in lower interest on long-term debt, partially offset by $0.3 million reduction in interest rate support.

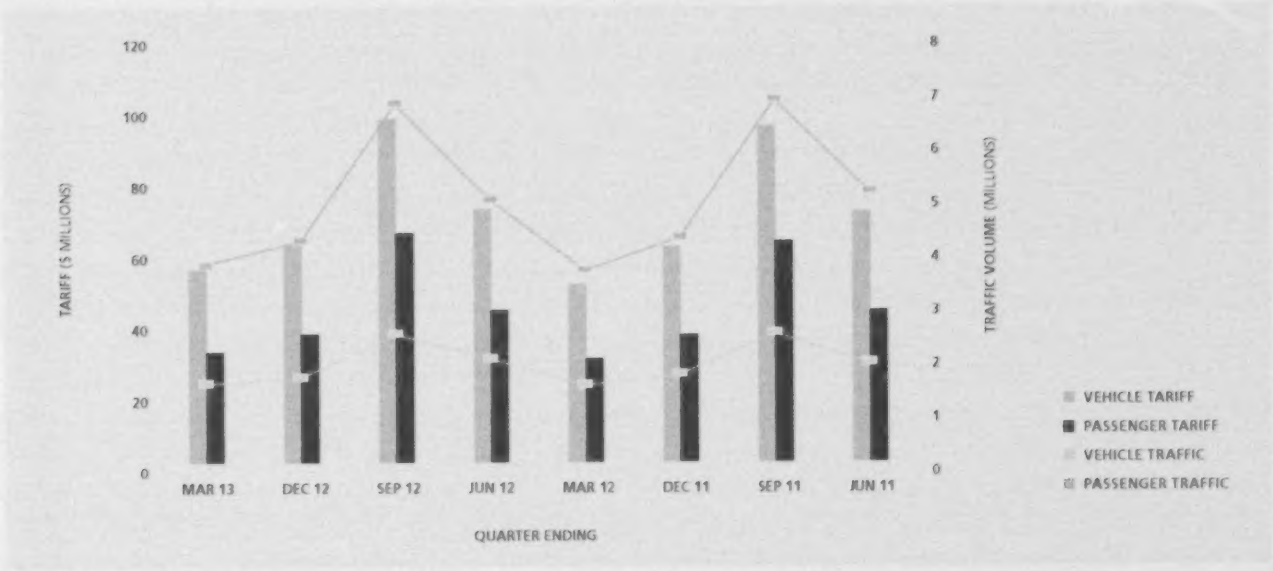
Summary of Quarterly Results

The table below compares IFRS earnings by quarter for the most recent eight quarters:

Quarter ended (unaudited) ($ millions)	Mar 13	Dec 12	Sep 12	Jun 12	Mar 12	Dec 11	Sep 11	Jun 11
Total revenue	**150.5**	169.6	268.7	197.6	145.0	164.9	256.9	187.0
Operating (loss) profit	**(20.2)**	0.2	84.1	20.7	(24.6)	(1.8)	73.5	13.7
Net (loss) earnings	**(37.1)**	(17.2)	66.5	3.3	(42.1)	(19.2)	55.8	(3.5)
Gain on land revaluation	**1.1**	–	–	–	2.2	–	–	–
Comprehensive (loss) income	**(36.0)**	(17.2)	66.5	3.3	(39.9)	(19.2)	55.8	(3.5)

Quarterly results are affected by the seasonality of leisure travel patterns. The second quarter, covering the summer period, experiences the highest traffic levels and the highest net earnings. The third and fourth quarters reflect a seasonal reduction in traffic. We utilize these periods to perform upgrades and major maintenance and refit programs, as well as to undertake mandatory inspections on the majority of our vessels.

The following graph demonstrates the seasonality of our revenue and shows the relationship of traffic volume and tariff revenue over the most recent eight quarters.



Investing in Our Capital Assets

CAPITAL EXPENDITURES

Capital expenditures in the three and twelve months ended March 31, 2013 totalled $39.1 million and $96.6 million, respectively.

($ millions)	March 31, 2013 3 Months	12 Months
Vessel upgrades and modifications	15.3	41.3
Terminal marine structures	12.3	27.5
Information technology	9.1	20.6
Terminal and building upgrades and equipment	2.4	7.2
Total capital expenditures	39.1	96.6

VESSEL UPGRADES AND MODIFICATIONS

Capital expenditures for vessel upgrades and vessel modifications in the three and twelve months ended March 31, 2013 included the following:

($ millions)	March 31, 2013 3 Months	12 Months
Major overhauls and inspections	7.0	20.1
Tachek life extension	4.5	5.7
Queen of Chilliwack life extension	0.1	3.3
Sewage treatment upgrade program	0.3	2.8
Kahloke right angle drive replacement	–	2.2
Propeller rebuilds and other upgrades	0.6	1.7
Cable ferry	0.8	1.0
Other projects	2.0	4.5
	15.3	41.3

The capitalization of major overhauls and inspections of our vessels is a significant IFRS change affecting us. (See "Accounting Practices – Adoption of New Accounting Standards" below.) Major overhauls and inspections completed to date or currently underway include:

- $4.9 million on the *Queen of Coquitlam*;
- $4.8 million on the *Spirit of British Columbia*;
- $2.2 million on the *Coastal Renaissance*;
- $2.0 million on the *Coastal Inspiration*;
- $1.8 million on the *Queen of Oak Bay*;
- $1.2 million on the *Quinitsa*;
- $0.9 million on the *Queen of Chilliwack* which is currently in progress and expected to be complete in the first quarter of the next fiscal year;
- $0.8 million on the *Bowen Queen*;
- $0.8 million on the *Kahloke* in conjunction with a $3 million project to replace two right angle drives and purchase a spare one for expected future replacement; and
- $0.7 million on the *Nimpkish*.

A $16 million project to extend the life of the *Tachek* by an additional 15 years until retirement in 2029 started in the third quarter. This life-extension includes new engines and shafting, new generators, and upgrades to lifesaving equipment and passenger facilities. The project is expected to complete in the third quarter of the next fiscal year.

The project to extend the life of the 33-year-old *Queen of Chilliwack* began in December 2010, with the first phase of a two-phase project that will allow the vessel to continue in service until it is retired in 2017 or later. The first phase of this $15 million project, completed during the first quarter of fiscal 2012, included new car deck watertight doors, new propeller seals, new instrumentation and control systems, new sewage treatment holding tank and pump out system, and new lifesaving systems. The second phase began in the fourth quarter of fiscal 2012 and included the installation of three new generators, electrical and HVAC system upgrades, and renewal of the propulsion control system. The vessel returned to service in the first quarter of this fiscal year, in time for the summer season. Fiscal 2013 ferry transportation fees for the Northern Routes increased $4.2 million as a result of this life extension.

Implementation of a $43 million multi-year sewage and waste water treatment program to upgrade 27 vessels for treatment of sewage generated onboard the vessels is complete. The program involved major modifications and upgrades to ensure that all vessels comply with *Canada Shipping Act, 2001* sewage regulations, which were effective May 3, 2012. Wherever possible, the vessels convey sewage to a terminal through pump-ashore infrastructure. In all other cases, the vessels have been fitted with compliant marine sanitation devices. All vessels in service are in compliance with the new regulations.

The $2.4 million project to replace two right-angle drives and keep a third as a spare, upgrade ventilation and electrical equipment, upgrade the alarm and monitoring system, modify the hatches, enlarge the wheelhouse, and upgrade lifesaving equipment on the *Kahloke* completed in the second quarter of this fiscal year.

Other projects completed this fiscal year include rebuilding three controllable pitch propeller hub systems, of which two were installed on vessels and one is being held as a spare; replacing five boilers on three vessels; and the first year of a four-year program to upgrade vessel electrical and navigational equipment including searchlights, gyro compasses, depth sounders, and radar equipment. Ongoing projects include vibration monitoring systems for shaft lines on five vessels and the start of a mid-life upgrade on the *Queen of Capilano*.

TERMINAL MARINE STRUCTURES

Capital expenditures for terminal marine structures in the three and twelve months ending March 31, 2013 included the following:

($ millions)		March 31, 2013	
Terminal	**Description**	**3 Months**	**12 Months**
Alert Bay	Replacement of wingwalls, towers, ramp and aprons	4.6	5.2
Swartz Bay	Berth 4 and 5 replacement and refurbishment	–	3.1
Horseshoe Bay	Upgrades at three berths	1.2	2.9
Tsawwassen	Berth 3 mid-life upgrade	0.2	2.6
Swartz Bay	Berth 1 mid-life upgrade	1.0	1.6
Prince Rupert	Tie-up dolphins and catwalk	–	1.5
Snug Cove	Dolphin upgrades	0.7	1.5
Westview	Replacement of trestle, ramp, apron and towers	0.8	1.5
Horseshoe Bay	Transfer deck life extension	0.6	1.3
Denman Island & Buckley Bay	Modifications to accommodate the new cable ferry	0.6	0.8
Little River	Replacement of tower, wingwall and dolphin	0.3	0.8
Village Bay	Replace double-sided floating lead	0.5	0.5
Various	Other projects	1.8	4.2
		12.3	27.5

At Alert Bay terminal, a $7.6 million project to upgrade wingwalls, towers, aprons and ramp is expected to be complete in the first quarter of the next fiscal year, in time for the busy summer season.

At Swartz Bay terminal:

- A $20 million project for the upgrade of berths 4 and 5 included replacement of ramps, ramp abutments, aprons, towers, wingwalls, dolphins and floating leads as well as electrical upgrades and a new waiting shelter. This project was completed in the second quarter of this fiscal year; and
- A $2 million mid-life upgrade of berth 1 included major mechanical, electrical and control components of the vehicle ramps and overhead walkway and was completed in the fourth quarter of this fiscal year.

At Horseshoe Bay terminal:

- A $2.9 million project to upgrade the ramps at berths 1, 2 and 3 completed in the fourth quarter of this fiscal year; and
- A $3 million project to extend the life of the transfer deck to provide an additional seven years of useful life is underway. This project is expected to be complete in the first quarter of the next fiscal year, in time for the busy summer season.

At Tsawwassen terminal:

- A $2.6 million project to upgrade the hydraulics, electrical and control systems and replace some structural and mechanical components on berth 3 completed in the third quarter of this fiscal year;
- Other projects at Tsawwassen terminal completed this fiscal year included apron modifications on berth 4 and finalization of a $9 million project to replace the dolphins, catwalk and sheet pile wall as well as to refurbish the hydraulic systems at berth 5.

At Prince Rupert terminal, a $1.5 million project to install new tie-up dolphins and a new catwalk will improve safety during the vessel mooring process. This project completed in the third quarter of this fiscal year.

At Snug Cove terminal, a $1.5 million project to replace one dolphin and modify a second dolphin completed in the fourth quarter of this fiscal year.

At Westview terminal, work is underway on a $20 million project to replace the existing trestle with one designed for full highway bridge loading with an improved approach radius, two traffic lanes and a pedestrian sidewalk; replace the ramp, ramp abutment, apron and towers with active lift hydraulics; and replace the waiting shelter. This project is expected to be complete by the end of fiscal 2014.

At Little River terminal, work is in progress on a $10 million project to replace the ramp, wingwall, tower, and dolphin. It is expected to be complete by the end of the next fiscal year.

Other projects in progress include replacement of the double-sided floating lead at Village Bay terminal; and the installation of tie-up winches at Tsawwassen, Langdale and Horseshoe Bay terminals. Projects completed this fiscal year include the replacement of the floating leads and wingwall at Saturna terminal and the replacement of floating leads at Crofton and Vesuvius terminals.

INFORMATION TECHNOLOGY

Capital expenditures for information technology in the three and twelve months ending March 31, 2013 included the following:

	March 31, 2013	
($ millions)	3 Months	12 Months
Customer service program	3.1	8.7
Infrastructure relocation program	2.9	3.3
Payroll system replacement	1.0	3.3
Computer hardware upgrades	1.4	2.9
Other projects	0.7	2.4
	9.1	20.6

Our customer service program will replace our aged point of sale and reservations systems and allow us to respond in a more timely fashion to changing business needs and to support marketing, travel services, and pricing initiatives. This program will also include terminal ticketing automation and customer relationship management systems. This five year program will be completed and implemented in stages starting in fiscal 2014, and is expected to be fully completed in fiscal 2016. We believe this program will significantly improve our ability to efficiently respond to the changing needs of our customers.

Our payroll system replacement initiative will replace both our payroll and labour distribution systems to provide added reliability and significant processing efficiencies and flexibility. This project is expected to be complete in the third quarter of fiscal 2014.

The $4.7 million infrastructure relocation program will relocate our prime data centre facility to the interior of British Columbia to mitigate risk in the event of a major incident such as an earthquake. Our current infrastructure site will be expanded to house our pre-production infrastructure and serve as our production environment for disaster recovery in the unlikely event that the interior data centre production services are interrupted.

Computer hardware upgrades continue as we proceed through our programs for replacement of aged computers, servers, cash registers and printers.

Other projects currently underway include enhancements for improved supply chain management, upgrades to simplify the process for customers making a reservation on our website, and upgrades to our computer operating systems and office software.

TERMINAL AND BUILDING UPGRADES AND EQUIPMENT

Capital expenditures for terminal and building upgrades and equipment in the three and twelve months ending March 31, 2013 included the following:

	March 31, 2013	
($ millions)	3 Months	12 Months
Tsawwassen shoreline stabilization	–	1.3
Vehicles and other equipment	0.8	1.3
Terminal waste water program	0.2	1.0
Maintenance facility upgrades	0.3	0.8
Horseshoe Bay electronic sign replacement	0.1	0.6
Terminal seismic upgrades	0.1	0.5
Equipment and other terminal projects	0.9	1.7
	2.4	7.2

Shoreline stabilization at Tsawwassen terminal was a $1.3 million project to install a filter layer and rip rap to increase the stability and drainage along the causeway shoreline. It was completed in the third quarter of this fiscal year.

Vehicles and other equipment include, among other items, heavy vehicles with service bodies; several vans and trucks; a truck with a flat deck welder; an electric car; two tugger tractors; and several waste compactors.

As part of the $20 million multi-year sewage and waste water treatment program for treatment of sewage generated onboard our vessels, pump ashore infrastructure is in service at seven terminals where sewage is collected and transferred to the municipal infrastructure. At most of these terminals, we pay ongoing fees to the local municipality based on volume transferred. A treatment plant has been installed at one terminal where there is no municipal infrastructure to connect with. As part of the federal government's Infrastructure Stimulus Fund program, we received $3.2 million in fiscal 2011 and a further $5.5 million in fiscal 2012 relating to sewage pump-ashore projects and other major terminal projects.

Other projects include construction of a plumbing shop and containment building at our maintenance facilities; replacement of our electronic signs at Horseshoe Bay terminal; and seismic upgrades at certain of our maintenance facilities.

Outlook

TRAFFIC LEVELS

Ferry traffic levels are affected by a number of factors, such as the economy, weather, transportation costs (including vehicle gasoline prices and ferry fares), the value of the Canadian dollar, global security, tourism levels, disposable personal income, demographics, and population growth. We are uncertain as to the individual or cumulative impact these items may have on our traffic levels. We are also uncertain as to the cumulative impact that tariff rate increases and the implementation and removal of fuel surcharges or rebates may have.

A summary of vehicle and passenger traffic over the last six years is shown below and a discussion of the changes over the years is discussed above in the "Financial and Operational Overview".

(thousands)	2013	2012	2011	2010	2009	2008
Vehicle Traffic by fiscal year						
Major routes	4,600.6	4,637.9	4,811.0	4,859.0	4,796.1	5,041.5
Other routes	3,120.3	3,172.4	3,279.2	3,365.3	3,302.6	3,503.4
Northern routes	27.8	27.6	29.3	31.1	31.7	33.8
Total	7,748.7	7,837.9	8,119.5	8,255.4	8,130.4	8,578.7
(Decrease) increase	*(1.1%)*	*(3.5%)*	*(1.6%)*	*1.5%*	*(5.2%)*	*0.7%*

(thousands)	2013	2012	2011	2010	2009	2008
Passenger Traffic by fiscal year						
Major routes	12,777.2	12,920.8	13,309.7	13,388.3	13,191.8	13,915.4
Other routes	7,061.0	7,168.5	7,350.5	7,559.1	7,441.7	7,771.3
Northern routes	80.9	80.7	86.0	88.2	94.0	101.8
Total	19,919.1	20,170.0	20,746.2	21,035.6	20,727.5	21,788.5
(Decrease) increase	*(1.2%)*	*(2.8%)*	*(1.4%)*	*1.5%*	*(4.9%)*	*0.5%*

In three of the last five months of the year ending March 31, 2013, our total traffic was higher than the same periods in the prior year, with increases of 2.9% in vehicle traffic and 3.0% in passenger traffic on our Major Routes in the last quarter. Every category of traffic was higher with the exception of buses. We believe the outlook for the travel industry and the US economy has improved, though not significantly. We also see signs of optimism in the global economy as volatility decreases in international markets. We expect these improvements will result in a limited recovery in discretionary traffic levels. Over the near term, we have terminal upgrades planned that are expected to cause a temporarily reduction in traffic on some of our routes. We anticipate the overall result to be no significant increase or decrease in overall traffic volume on all our routes.

MARKET OPPORTUNITIES

We are constantly looking for innovative ways to serve our customers and actively pursue opportunities for growth.

Our drop trailer service, launched in March 2009, operates on two of our Major Routes. Our commercial customers on these routes can drop their trailers off at one terminal and pick them up at another. This drop trailer service is the fastest growing segment of our market with increases in revenue over the past three years of 34%, 54%, and 58%, respectively. The service also improves our overall productivity by utilizing otherwise unused capacity. We expect to see modest growth in drop-trailer traffic over the next few years as general economic conditions improve and our overall commercial market share to remain relatively stable.

In May 2010, we opened our vacations centre, which is conveniently located in the tourist sector of downtown Vancouver. Through the use of our travel centre and an integrated marketing approach, we are able to leverage off of our core business to drive incremental ferry traffic as well as generate commissions from the related services. Using a 37-foot long interactive media wall display, customers are able to view route maps, vessel schematics, and destination images to help them choose from a variety of travel package options. In fiscal 2013, the number of vacation packages sold, as well as the average price per package, increased over the prior year generating over $2.9 million in revenue, a 22% increase from fiscal 2012. As the economy strengthens, we expect to see continuing growth, leading to increased traffic volumes as well as incremental non-tariff revenue.

We also have opportunities for continued growth with our onboard retail gift shops. Approximately 40% of our gift shop sales are clothing. Sales of our quality clothing have grown over the past three years with increases of 13.0% in fiscal 2011, 14.8% in fiscal 2012 and 13.8% in fiscal 2013.

ASSET RENEWAL PROGRAM

We have one of the largest fleets in the world. The average age of our assets was among the oldest of major ferry operators worldwide. To address this, we instituted a multi-year major fleet and asset renewal program which involved upgrading and replacing a large share of our fleet and terminal assets. The most significant portion of our asset renewal program was completed during fiscal 2010.

Over a number of years, this program saw seven new vessels being added to our fleet, many other vessels significantly upgraded and numerous improvements to our terminal assets. The entry of the new vessels into service and asset revitalization has reduced the average age of our major vessels from 33 years to 19 years and assists in maintaining operational reliability.

($ millions)	2013	2012	2011	2010	2009	2008	2007
Capital expenditures by fiscal year							
Vessel upgrades & modifications	39.9	47.6	43.8	21.5	75.7	53.7	55.8
Terminal marine structures	27.5	44.0	41.6	22.5	31.0	26.6	38.0
Information technology	20.6	18.6	17.2	15.5	14.2	15.2	6.9
Terminal & building upgrades & equipment	7.2	11.1	24.5	15.1	24.3	27.9	11.7
Total (without new vessels)	95.2	121.3	127.1	74.6	145.0	123.4	112.4
New vessels	1.4	0.9	1.6	6.8	348.7	329.1	150.2
Total (including new vessels)	96.6	122.2	128.7	81.4	493.9	452.5	262.6

In fiscal 2010, the costs for the new major vessels were finalized and design costs for the new minor and intermediate sized vessels, including the cable ferry, began.

Average annual capital expenditures over the last seven years were $234.0 million in total, $114.1 million excluding new vessels.

We are in the planning stages of our second new build program focused on our minor and intermediate sized vessels. The typical life span of vessels is 40 to 45 years and our minor and intermediate sized vessels currently have an average age of 38 years. As the identified replacement dates approach, we will undertake a full review of these vessels to determine if any are candidates for life extension rather than replacement. Our expectation is that we will need to replace four to five of these vessels over the next 10 years.

The first new vessel will be a cable ferry as detailed below. When the cable ferry comes into service, it will allow us to retire the 49 year-old *Tenaka*.

Our strategy for new vessels includes design optimization, interoperability, and standardization of vessels across the fleet, to the extent possible, to provide more flexibility to respond to changes in the market demand and traffic forecasts. We also plan to adopt liquefied natural gas (LNG) as a fuel source where feasible.

The *Queen of Burnaby* (48 years old) and the *Queen of Nanaimo* (49 years old) have been earmarked for replacement and several options are being considered. Our recommended option is to replace these two vessels with two 145 car capacity open-deck vessels and one 125 car capacity open deck vessel that would be available for additional sailings when the demand is high and temporary vessel replacement for several other vessels when they are undergoing maintenance. The options have been presented to the Commissioner for his review and approval.

Significant upgrades at our terminals that support our Major Routes are substantially complete and work is commencing on replacing marine structures, buildings and other improvements at our terminals that support our other routes.

CABLE FERRY

After four years of studying the feasibility of a cable ferry, on November 23, 2012, we announced that we are proceeding with plans to design and build a cable ferry for service on one of our shortest routes between Buckley Bay on Vancouver Island and Denman Island.

Our extensive design and analysis conducted to date included: validation of environmental conditions; hydrodynamic testing of the vessel; cable load analysis and dynamic interaction of the ferry and berths; and the determination of operational criteria, cable specification and safety factors. Regulatory approvals for the cable ferry have been obtained, including approval from the Department of Fisheries and Oceans under the *Canadian Environmental Assessment Act* and Transport Canada approval under the *Navigable Waters Protection Act*. We have now moved into the detailed design phase for the cable ferry and for the terminal infrastructure. We expect to conclude a procurement process for the construction of the vessel and terminal works by the coming summer. The new 50-car vessel is expected to be in service by the fall of 2014. The cable ferry is an innovative initiative and is part of our ongoing efforts to identify and pursue opportunities that have the potential to enhance our cost effectiveness in delivering safe, reliable and quality ferry service.

FUEL CONVERSION

On October 29, 2012, we submitted a fuel strategies report to the Commissioner which included our plan for transition to alternate fuels. We have been studying the feasibility of using LNG and believe that a move to this fuel source would reduce costs and emissions. At this time, LNG is over 50% less expensive than the ultra low sulphur diesel we currently use. LNG, as well as the fuel we currently use, meets all current and proposed domestic and international emissions regulations. We believe that LNG is a viable option for future new vessels. We are also analyzing LNG as an option for existing vessels undergoing major retrofits and intend to pursue the option where it is economically and technically feasible. We have several existing vessels scheduled for mid-life upgrades beginning in fiscal 2015.

ALTERNATIVE SERVICE PROVIDERS

In an effort to reduce costs on our regulated routes, from time to time we test the market to determine if another operator, under contract to us, could provide safe, reliable and high quality service that is more cost-effective. In addition, under section 69 of the Act the Commissioner has the authority to require us to provide a plan to seek alternative service providers.

In May 2012, we issued a Request for Proposal to third parties interested in providing, under contract to us, passenger and vehicle cable ferry service on our route between Buckley Bay and Denman Island. We concluded that we will operate the route ourselves as we can run it in a more cost-effective manner than an alternate service provider while maintaining a high level of safety, quality and reliability.

REGULATION

On January 1, 2013, the requirement to maintain a Shipboard Energy Efficiency Management Plan (SEEMP) came into force for all vessels that are governed by International Maritime Organization (IMO) standards. We have been provided with a draft SEEMP for the *Northern Adventure*, our only vessel under IMO standards, for potential adoption or amendment. The SEEMP identified measures the vessel can implement to reduce loading time and fuel consumption and thereby reduce emissions. We have already implemented a number of measures by standardizing operations, optimizing load distribution, and going to shore power when along shore, so do not expect any significant impact as a result of implementing this SEEMP.

The North American Emissions Control Area (ECA) in now in force in Canada. The *Regulations Amending the Vessel Pollution and Dangerous Chemicals Regulations*, promulgated under the *Canada Shipping Act, 2001* were adopted on April 18, 2013 and were published on May 8, 2013. The ECA sets controls on sulphur dioxide, nitrogen dioxide and particulate levels. We are currently well below the 2015 requirements regarding sulphur dioxide, and requirements for nitrogen dioxide levels for new vessels can be met through the use of LNG or the installation of exhaust scrubber technology.

We expect composting bylaws banning landfill disposal of organics to be implemented in fiscal 2015. We are well positioned for these new bylaws as we currently have a composting program which we are expanding in fiscal 2014 to a third Major Route.

The designation of marine protected areas and use of integrated marine management is gaining momentum within the coastal waters of British Columbia. There are currently a number of marine area planning processes underway that will decide who has access to marine resources and how these resources are managed. We are paying close attention to these processes to ensure there is no impact on our operations.

FINANCIAL OUTLOOK

We do not anticipate that economic conditions or our traffic levels will materially change in the near term and are continuing our program of cost containment and deferrals, while maintaining safe, reliable service. However, we have no plans to reduce our planned refit and maintenance programs, training and safety programs or capital programs.

We expect positive net earnings in fiscal 2014, as a result of a combination of ferry transportation fee increases, reasonable adjustments to service levels and modest increases in fares, coupled with a gradual improvement in the overall economy and continued cost management.

Financial Risks and Financial Instruments

Exposure to credit risk, liquidity risk and market risk arises in the normal course of our business. We manage market risk arising from the volatility in foreign currency, interest rate, and fuel price exposures in part through the use of derivative financial instruments including forward contracts, swaps and options. We do not utilize derivative financial instruments for trading or speculative purposes.

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates cannot be determined with precision as they are subjective in nature and involve uncertainties and matters of judgment. Where the market prices are not available, fair values are estimated using discounted cash flow analysis based on our current borrowing rate for similar borrowing arrangements.

CREDIT RISK

We limit our exposure to credit risk on cash and investments by investing in liquid securities with high credit quality counterparties, and placing limits on the tenor of investment instruments and maximum investments per counterparty. We manage credit exposure related to financial instruments by dealing with high credit quality institutions, in accordance with established policy and parameters and by an ongoing review of our exposure to counterparties. Counterparty credit rating and exposures are subject to approved credit limits and are monitored by us on an ongoing basis. Counterparties with which we have significant derivative transactions must be rated "A" or higher. We do not expect any counterparties to default on their obligations.

Our credit risk from trade customers is limited by having a large and diversified customer base and is managed through the review of third-party credit reports, utilizing pre-authorized payment plans, monitoring of aging of receivables, and collecting deposits and adjusting credit terms for higher risk customers. Amounts due from the Province and the Government of Canada are considered low credit risk. At March 31, 2013, 54% of our trade and other receivables were comprised of amounts due from the Province and the Government of Canada and 96% of our trade and other receivables are current.

LIQUIDITY RISK

We target a strong investment grade credit rating to maintain capital market access at reasonable interest rates. Our financial position could be adversely affected if we fail to arrange sufficient and cost effective financing to fund, among other things, capital expenditures and the repayment of maturing debt. This is subject to numerous factors, including the results of our operations, our financial position, conditions in the capital and bank credit markets, ratings assigned by rating agencies and general economic conditions.

We deem liquidity risk to be low at this time as we do not foresee the need to access the capital markets in the near term, other than to refinance maturing bonds.

We manage liquidity risk through daily monitoring of cash balances, the use of long-term forecasting models and the maintenance of a credit facility and debt service reserves. Our credit ratings at March 31, 2013, were "A" (DBRS) with a stable trend and "A+" (S&P) with a stable outlook.

MARKET RISK

INTEREST RATE

Our exposure to interest rate risk is limited to interest expenses associated with our short-term borrowings, floating rate debt and any new long-term issues and to earnings associated with interest rate movement beyond the term of the maturity of fixed rate short-term investments. To manage this risk, we maintain between 70% and 100% of our debt portfolio in fixed rate debt, in aggregate. In addition, we may enter into interest rate agreements to manage our exposure on debt instruments. A 50 basis point change in interest rates would not have had a significant effect on our fiscal 2013 earnings. We have two bond issues totalling $390 million that will mature within the next two years ($140 million in December 2013 and $250 million in May 2014). It is our intention to refinance these bonds and we will be monitoring the capital markets for appropriate opportunities, including early redemption. A 100 basis point change in interest rates from the current bond coupon rates would result in a change in future annual earnings of $3.9 million.

FOREIGN CURRENCY

We are also exposed to risk from foreign currency prices on financial instruments, such as accounts payable denominated in currencies other than the Canadian dollar. To manage exposure on future purchase commitments, we review our foreign currency denominated commitments and hedge through derivative instruments as necessary. A 10% change in the US dollar or Euro foreign exchange rates would not have had a significant effect on our fiscal 2013 earnings.

FUEL PRICE

Our exposure to fuel price risk is associated with the changes in the market price of marine diesel fuel. Fuel costs have fluctuated significantly over the past few years and there is uncertainty of the cost of fuel in the future.

To mitigate the effect of volatility in fuel oil prices on our earnings, we use deferred fuel cost accounts together with fuel surcharges or rebates as required. (See "The Effect of Rate Regulation" above for more detail.)

High levels of fuel pricing could translate into significant fuel surcharges and result in unprecedented total tariff levels. There is uncertainty of the impact on future ferry traffic levels if fuel surcharges and therefore total tariff levels rise significantly. There is a risk of a decline in ferry traffic levels as a result of increasing customer costs resulting from the implementation of fuel surcharges.

We also may manage our exposure to fuel price volatility by entering into hedging instruments in order to reduce price volatility and add a fixed component to the inherent floating nature of fuel prices. Fuel price hedging instruments are used solely for the purpose of reducing fuel price risk, not for generating trading profits. Pursuant to our Financial Risk Management Policy, the term of the contracts is not to extend beyond three years. This policy limits hedging to a maximum of 95% of anticipated monthly fuel consumption for the immediately following 12 month period, 90% of anticipated monthly fuel consumption for the 12 month period thereafter, and to 85% of anticipated monthly fuel consumption for the remaining 12 month period. Fuel forward contracts are only entered into when there is a reasonable likelihood that the hedge will result in a net procurement cost per litre less than or equal to the set price per litre established by the Commissioner. At March 31, 2013, we did not have any outstanding fuel forward contracts. Gains and losses resulting from fuel forward contracts are recognized as a component of fuel costs.

DERIVATIVES

We hedge our exposure to fluctuations in fuel prices and foreign currency exchange rates from time to time through the use of derivative instruments. At March 31, 2013 we held three foreign exchange forward contracts with a carrying and fair value of $12 thousand while at March 31, 2012 we held six such contracts with a carrying and fair value of $12 thousand. There were no commodity derivatives in place at March 31, 2013 or March 31, 2012.

The fair value of commodity derivatives would reflect only the value of the commodity derivatives and not the offsetting change in value of the underlying future purchase of fuel. The fair values would reflect the estimated amounts that we would receive or pay should the derivative contracts be terminated at the stated dates. For regulatory purposes, any gains or losses related to fuel commodity swaps would be charged to our deferred fuel cost accounts. (See "The Effect of Rate Regulation" above for more detail.)

NON-DERIVATIVE FINANCIAL INSTRUMENTS

The carrying and fair values of non-derivative financial instruments at March 31, 2013, and 2012 are as follows:

	2013		2012	
($ millions)	**Carrying Value**	**Fair Value**	**Carrying Value**	**Fair Value**
Financial Assets				
Cash and cash equivalents	**36.7**	**36.7**	7.7	7.7
Restricted short-term investments	**35.6**	**35.6**	35.7	35.7
Other short-term investments	**43.4**	**43.4**	26.9	26.9
Trade and other receivables	**18.1**	**18.1**	42.3	42.3
Long-term loan receivable	**24.5**	**24.5**	24.5	24.5
	158.3	**158.3**	137.1	137.1
Financial Liabilities				
Accounts payable and accrued liabilities	**51.8**	**51.8**	50.7	50.7
Short-term debt	**–**	**–**	17.7	17.7
Interest payable on long-term debt	**18.1**	**18.1**	18.2	18.2
Provisions	**50.8**	**50.8**	47.0	47.0
Long-term debt, including current portion	**1,286.2**	**1,486.7**	1,294.2	1,491.0
	1,406.9	**1,607.4**	1,427.8	1,624.6

The fair value of all financial instruments included above, with the exception of long-term debt, approximate their carrying amounts due to the nature of the item and/or the short time to maturity.

The carrying value of long-term debt is measured at amortized cost using the effective interest rate method. Fair value is calculated by discounting the future cash flow of each debt issue at the estimated yield to maturity for the same or similar issues, or by using available quoted market prices.

Business Risk Management

We continue to employ a variety of commonly accepted methodologies to identify, assess and mitigate risks. We have processes in place throughout our company to manage risks that inevitably arise in the normal course of business.

We do not believe that material uncertainties exist in regards to our future. As part of our risk management strategies, we have considered many items such as profitability levels, cash generating potential, cash utilization requirements including debt repayment schedules and future capital expenditures, and working capital requirements. We have taken measures to allow us to weather the economic downturn and ensure a viable, profitable future.

CUSTOMER DEMAND

Our vehicle and passenger traffic levels in fiscal 2013, as compared to the prior year, declined 1.1% and 1.2%, respectively. The decline in traffic was experienced across the Major and Other Routes.

We believe that high fuel prices and a strong Canadian dollar have driven people who would traditionally travel to Vancouver Island to travel to the United States instead. The global downturn has also caused a decline in European travellers on our routes. Many factors affect customer demand, including current economic conditions, levels of tourism and discretionary travel. The cost of transportation, including the price of fuel at the pump and ferry fares (including the implementation and removal of fuel surcharges or rebates), disposable personal income, heightened global security and weather conditions may have a negative effect on discretionary travel and levels of tourism.

We are uncertain as to the individual or cumulative impact these items may have on our revenue. No assurance can be given as to the level of traffic on our system and the resulting tariff revenues.

Risk mitigation: We are constrained by the CFSC, which stipulates, among other things, the number of round trips that must be provided for each regulated ferry route. Within these constraints, we actively manage our capacity in an efficient and effective manner to ensure we can react quickly to changing levels of demand within the restrictions of the CFSC.

In fiscal 2013, the CFSC was amended to allow a reduction in the service requirement on three of our Major Routes and set targets for further service level reductions system wide. We implemented reductions in round trips on those Major Routes, where the traffic levels no longer warranted extra service or where service was significantly under-utilized. These identified reductions equate to 1% of our annual round trips on these routes. This allows us some flexibility in eliminating trips that have been historically underutilized. Further adjustments to service levels, as discussed above, are expected in the future.

Vessel planning strategies are in place with the goal of standardization so we can better respond to changes in customer demand. We also regularly review and update our short and long-term financial and operating plans to ensure appropriate alignment of expenses with revenue.

SECURITY OF INFORMATION

Deliberate or inadvertent release of confidential or sensitive information, whether in paper or electronic format, could have an adverse effect on the lives of our employees and customers as well as negatively impact our reputation. A significant loss of confidential management information could also negatively impact our financial position and results of operations.

Risk mitigation: Governance is in place for ensuring information privacy.

Our information security policy has been developed and is being implemented. Standard procedures for access and use of private data have been implemented. Multiple levels of technology controls are in place and networks, websites and databases are monitored to detect potential issues. Information technology projects are delivered using the 'security by design' principle. Regular security scans by trusted and qualified vendors are conducted on a quarterly basis.

Communication to employees of their responsibility to protect private information is ongoing and a formal awareness and training program is in place.

SECURITY

Deliberate, malicious acts could cause death, injury or property damage. The occurrence of a major incident or mishap could negatively affect the propensity for the public to travel, reducing our ferry traffic levels. It could also lead to a substantial increase in insurance and security costs.

Any resulting reduction in tariff revenues and/or increases in costs could have a material adverse effect on our business prospects, financial condition and results of operations.

Risk mitigation: Security initiatives are in place to counter intentional attacks. Our 24-hour operations and security centre provides enhanced situational awareness and assessments, increased security monitoring, and a coordinated response during any incidents.

We are committed to our multi-year project to upgrade security at our terminals and maintenance facilities. This project primarily involves fencing, gating, lighting, access controls, and closed circuit television, as well as upgrades to foot passenger ticketing areas, baggage screening, and the use of canine patrols.

We also have a sound conventional insurance program designed to mitigate the financial impact of a major incident. However, there can be no guarantee that the insurance coverage will be sufficient to cover all such incidents.

ECONOMIC REGULATORY ENVIRONMENT

We cannot predict what changes the Province may make to the Act or to other legislation, nor can we predict how the Commissioner's interpretation and administration of the Act may change over time. Such changes may impact our profitability. (See "Corporate Structure – Economic Regulatory Environment" above for more detail.)

The Commissioner has released the final price caps for the remaining three years of performance term three, April 1, 2013 to March 31, 2016. These price caps represent increases averaging 4.0% per annum. The order indicated the Commissioner has the intention of allowing us to achieve, by the end of the third performance term, equity not lower than 17.5% of total capitalization and a DSCR of 2.5 or higher. There remains uncertainty in the Commissioner's future price cap rulings.

Risk mitigation: We strive to maintain regular and open communications and positive relationships with the Province, the Commissioner, the Deputy Commissioner and local Ferry Advisory Committees that represent the interests of the communities we serve.

ACCESS TO CAPITAL MARKETS

Our ability to arrange sufficient, cost-effective and timely debt financing could be materially adversely affected by numerous factors: our economic regulatory environment, our results of operations and financial position, market conditions, our credit ratings and general economic conditions.

Any failure or inability to borrow on satisfactory terms when required could impair our ability to repay maturing debt, fund necessary capital expenditures and meet other obligations and requirements and, as a result, could have a material adverse effect on our ongoing operations.

Risk mitigation: We strive to communicate to our stakeholders the importance of our financial viability within our economic regulatory framework and our commitment to maintaining financial strength, in order to access these important markets.

SAFETY

The safety of the public and our employees is our highest priority. However, there is a risk to passenger and employee safety and/or property damage as a result of the ineffectiveness of policy and procedures, equipment, maintenance, training, supervision, facility design and security measures.

We also have significant food and beverage sales, both on our vessels and at our terminals, and there is a risk of a foodborne illness contracted from contaminated products purchased from our food services.

A significant damage, injury or illness event could have an adverse effect on the lives of our employees and customers, our ability to meet operational service requirements, the environment, staff morale, our reputation and our financial position and results of operations.

Risk mitigation: Our safety program, SailSafe, launched in fiscal 2008, is a joint initiative with the Union and involves all employees. It has been successful in changing our culture of safety awareness. The objective of the SailSafe program is to ensure that safety is kept as the primary concern in the minds of our employees each and every day. As part of the SailSafe program, we have upgraded our safety management system including the introduction of an operational risk assessment and management process.

Our food storage, handling, preparation and cooking procedures are aligned with the hazard analysis critical control point (HACCP) methodology which is a preventive approach to food safety. HACCP is an industry-wide effort approved by the scientific community, as well as by regulatory and industry practitioners.

We also adhere to a program of internal and external safety audits designed to verify our compliance with our safety management system. We also have a sound conventional insurance program designed to mitigate the financial impact of a major incident. However, there can be no guarantee that the insurance coverage will be sufficient to cover all such incidents.

REGULATIONS – ENVIRONMENTAL

Our operations are subject to Federal, Provincial and local environmental laws and regulations dealing with various operations, including solid and liquid waste management, air quality and oil spill response.

The provincial government has made a commitment to reduce greenhouse gas emissions (GHG) by 33% by the year 2020, based on emissions in 2007. While the reduction targets have not yet been set, the transportation industry has been identified as a sector that will have emission limits.

If we were to be involved in an environmental accident or be found in material violation of applicable law and regulations, we could be responsible for material clean-up costs, repair of property damage, and fines or other penalties.

Risk mitigation: We will continue to comply with environmental laws and regulations and actively search for ways to improve our environmental performance to help us become an industry leader in environmental management. We have training programs in place that include training our staff in first response to an oil spill.

We constantly look for ways to reduce fuel consumption and emissions on our vessels. We continue to use ultra low sulphur diesel with a 5% biodiesel component on all of our vessels across the fleet and we currently meet the North American Emission Control Area standards for sulphur content that have been set for 2015. We have implemented a wide variety of fuel saving measures ranging from operating our vessels more efficiently to installing new, more fuel-efficient engines on some of our vessels and fuel monitoring systems on others and designing and building our new vessels to meet or exceed current environmental standards.

We are also actively pursuing LNG options for new vessels and vessels undergoing major retrofits because we believe that a move to this fuel source would reduce emissions as well as costs. LNG, as well as the fuel we currently use, meets all current and proposed domestic and international emissions regulations.

We have programs in place to protect the environment and reduce GHG. Besides using biodegradable hydraulic oils, we recycle beverage containers, cardboard, newsprint, plastics, wood, metal, spent fluorescent tubes, batteries, aerosol spray cans, and used cooking oil. We also have a composting program which we are in the process of expanding. Currently we divert 80 to 90 tonnes of compostable material annually on two of our Major Routes. We continue to replace chemical products with more environmentally friendly solutions and have replaced gasoline powered terminal vehicles with electric vehicles and gasoline powered baggage vans with propane powered tugger units. We also reduce GHG levels by transferring vessels to shore-power while berthed overnight, promoting anti-idling and increasing waste diversion.

We have also introduced new initiatives to further mitigate our environmental impact. A multi-year sewage and waste water treatment program to upgrade 27 vessels and eight terminals for treatment of sewage generated by the vessels is now complete. Wherever possible, the vessels convey sewage to a terminal through pump-ashore infrastructure. Where terminal facilities are not available, small vessels were fitted with holding tanks, with truck pump-off. In all other cases, the vessels have been fitted with federally compliant marine sanitation devices. We have a treatment plant at one of our terminals while at the remaining seven sewage is collected and transferred to treatment plants operated by local governments. (See "Investing in our Capital Assets" above for more detail.)

We believe that we maintain adequate environmental insurance; however, there can be no guarantee that the insurance coverage will be sufficient to cover all such losses.

REGULATIONS – OTHER

Our operations are subject to a wide variety of national and local laws and regulations, all of which may change at any time.

There is the potential that the introduction of new safety or other regulations, including new taxes, or the interpretation of existing regulations, may impose a new, unexpected and significant cost burden and/or result in major disruptions to our operations.

Risk mitigation: We foster positive relationships with local officials and treat recommendations and advisories with respect and due consideration. Appeals are made to higher authorities as required.

We continue to seek reasonable and cost effective solutions for compliance with new regulations through our planning processes and asset renewal initiatives.

We also have the opportunity to apply to the Commissioner under section 42 of the Act for an extraordinary price cap increase or other relief if the introduction of new safety or other regulations impose a new, unexpected and significant cost burden.

PERFORMANCE RISK

The occurrence of a major incident or mishap could result in default under the CFSC unless such accident or mishap qualified as an event of force majeure.

The occurrence of a default under the CFSC could have consequences, including an adjustment to ferry transportation fees from the Province or the forced sale of our vessels to the Province for net book value and termination of the Terminal Leases.

Risk mitigation: We have an asset renewal program for our vessels and terminals, a major portion of which has already been completed. This program is revitalizing our fleet and upgrading our terminals to support our ongoing operations and maintain service reliability.

We regularly update our vessel maintenance schedules to ensure that we provide the core service levels required under the CFSC.

We continuously monitor our operations from our 24-hour operations and security centre. This provides enhanced situational awareness and assessments to identify and prevent potential incidents and provides a coordinated response to any incident that may occur.

TAXES

We received an advance income tax ruling from Canada Revenue Agency (CRA) that, provided the facts and other statements set out therein are accurate, we are a "Tax Exempt Corporation" described in paragraph 149(1)(d.1) of the *Income Tax Act*. This ruling was subject to a proposed amendment to subsection 149(1.3) of the *Income Tax Act* announced by the Department of Finance on December 20, 2002. The essential elements of this amendment were included in Bill C-48, which received Second reading in the Senate on June 6, 2013 and was referred to the Standing Senate Committee on Banking, Trade and Commerce. It was reported back with observations on June 13, 2013 but, as of June 20, 2013, had not yet completed Third Reading. There is no reason to believe that Bill C-48 will not be passed into law. We have received a non-binding opinion from CRA that subsection 149(1.3), if amended as proposed on December 20, 2002, will not cause us to cease to be a Tax Exempt Corporation.

There can be no assurance that subsection 149 (1.3) of the *Income Tax Act* will be amended as proposed, or that we are and will continue to be a Tax Exempt Corporation.

Risk mitigation: We have the opportunity to apply to the Commissioner under section 42 of the Act for an extraordinary price cap increase or other relief if the introduction of new regulations imposes a new, unexpected and significant cost burden.

TREATY NEGOTIATIONS: ABORIGINAL RIGHTS AND TITLE

Much of British Columbia, including areas where we have operations and real property interests, is subject to claims of aboriginal rights or title. Canadian courts have recognized that aboriginal peoples may enjoy constitutionally protected rights, whether or not recognized in a treaty, in respect of lands that were used or occupied by their ancestors. These rights vary from the right to use lands and waters to carry out traditional activities (for example, an aboriginal right to fish) to the right to exclusively occupy lands that are subject to aboriginal title. What kind of right might exist depends primarily upon the nature and extent of the prior aboriginal use and occupation at specific dates in British Columbia's history.

At present, many aboriginal groups, who claim that they have un-extinguished Aboriginal rights and title, are seeking recognition of those claimed rights in modern treaties, or in government decision-making that may affect their traditional territories. Canadian courts have confirmed that provincial and federal governments have a duty to consult with and, if appropriate, accommodate aboriginal groups when they are proposing to make a decision that could potentially infringe asserted Aboriginal rights and title. Government approvals and licences, such as those required to operate existing terminal facilities or develop new ones, may trigger the government's duty to consult with any aboriginal groups whose claims of Aboriginal rights and title might be adversely affected by the granting of the licence or approval in question. Recent court decisions have clarified that the Crown, when making decisions, does not have to accommodate Aboriginal groups for historic infringements, though historic infringements may be taken into consideration in addressing proposed new infringements.

Aboriginal groups that have entered into treaties may have a right to be consulted with respect to government actions that could adversely affect their treaty rights. Modern treaties may also require the Crown to consult with an Aboriginal group with respect to certain kinds of government action in certain geographic areas, depending on the terms of the treaty.

Risk mitigation: Under the master agreement, the Province retains its liability, to the extent any exists, for the acts and omissions of the Province that occurred prior to our possession of the ferry terminal properties leased under the Terminal Leases and will reimburse us for any damages we suffer as a result. The Province will reimburse us for damages suffered if there is a final court decision or a treaty settlement that recognizes or confers upon an aboriginal group a proprietary or other interest in the ferry terminal properties should that right or interest interfere with our quiet enjoyment of the ferry terminal properties as set out in the Terminal Leases.

Accounting Practices

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our discussion and analysis of our financial condition and financial performance is based upon our consolidated financial statements, which have been prepared in accordance with International Financial Reporting Standards.

Our significant accounting policies are contained in note 1 to our consolidated financial statements. Certain of these policies involve critical accounting estimates because they require us to make particularly subjective or complex judgments about matters that are inherently uncertain and because of the likelihood that materially different amounts could be reported under different conditions or using different assumptions. These judgements, estimates and assumptions are subject to change as new events occur, as more experience is acquired, as additional information is obtained and as the general operating environment changes.

We believe the following are the most critical accounting policies, estimates, and judgements that we have used in the preparation of our financial statements.

WORKERS' COMPENSATION CLAIMS LIABILITY

Our financial statements include an estimate of residual liability for workers' compensation claims arising from the Workers' Compensation Board deposit class coverage system, in which our predecessor entity participated on or prior to March 31, 2003.

An actuarial valuation of the unfinalized claims remaining to be paid at March 31, 2011 that relate to incidents on or prior to March 31, 2003 was received in fiscal 2012 and the accrued benefit obligation estimated at $2.7 million. The residual liability balance ($1.7 million at March 31, 2011) was increased during fiscal 2012 by $1.0 million to adjust to this estimate. This residual liability is drawn down as claims are paid. The remaining balance at March 31, 2013 of $1.9 million ($2.4 million at March 31, 2012) is included in accrued employee future benefits in our financial statements.

PUBLIC SERVICE PENSION PLAN

Our employees are members of the Public Service Pension Plan (the Plan), a defined benefit and multiemployer pension plan. The Plan is exempt from the requirements under the provincial *Pension Benefits Standards Act* to use the "solvency" method in conjunction with the "going concern" method for valuation purposes. As such, the Plan is currently valued solely by the going concern method. The most recent valuation, as at March 31, 2011, indicated an unfunded liability of $275 million across the total Plan.

Effective April 1, 2012, the Public Service Pension Board of Trustees increased contribution rates to the basic account for plan members and employers from 7.78% to 8.18% of pensionable earnings each, primarily due to the change in the investment return and demographic assumptions. The contribution rates to the inflation adjustment account for members and employers changed from 1.50% and 2.50% to 1.25% and 2.75%, respectively.

RETIREMENT BONUS LIABILITY

We sponsor a plan that provides a post-retirement benefit for eligible long service employees. The valuation of this plan is estimated based on complex actuarial calculations using several assumptions. These assumptions are determined by management with significant input from our actuary. The valuation of the obligation depends on such assumptions as discount rate, projected salary increases, retirement age and termination rates. An actuarial valuation of the plan at March 31, 2011, was obtained and the accrued benefit obligation estimated at $13.8 million. The liability included in accrued employee future benefits in our financial statements at March 31, 2013, was $13.9 million ($13.6 million at March 31, 2012). At April 1, 2011, the liability balance was increased by the amount of the unamortized actuarial loss of $3.6 million. (See "First-time adoption of IFRS" below for more detail.)

We have adopted the corridor method of recognizing actuarial gains and losses. Any gains and losses in excess of 10% of the obligation balance will be amortized over the average remaining service period of employees expected to receive benefits under this plan. IAS 19 *Employee Benefits* has been amended and becomes effective for us on April 1, 2013. As a result of the amendments, actuarial gains and losses will be immediately recognized in other comprehensive income rather than net earnings and the option to use the corridor approach to recognize these costs over time will no longer be available.

DEPRECIATION AND AMORTIZATION EXPENSE

Our capital assets, including assets under finance leases, are depreciated or amortized on a straight-line basis at varying rates. Depreciation and amortization rates require the use of estimates of the useful lives of the assets and of salvage value to be realized upon asset retirement.

We annually review asset lives in conjunction with our longer term asset deployment, replacement and upgrade strategies. When we determine that asset lives do not reflect the expected remaining period of benefit, we make prospective changes to the remaining period over which they are depreciated or amortized. There are a number of uncertainties inherent in estimating our asset lives and changes in these assumptions could result in material adjustments to our financial statements.

As disclosed in note 1 to our financial statements, we review and evaluate our long-lived assets for impairment when events or changes in circumstances indicate that the related amounts may not be recoverable.

HEDGING RELATIONSHIPS

We utilize derivative financial instruments to manage market risk against the volatility in foreign currency, interest rate, and fuel price exposures. We do not utilize derivative financial instruments for trading or speculative purposes. At the inception of each hedge, we determine whether or not to apply hedge accounting.

When applying hedge accounting, we document all relationships between hedging instruments and hedged items, as well as our risk management objectives and strategy for undertaking various hedge transactions. This process includes linking all derivatives to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. We also assess, both at the hedge inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are effective in offsetting changes in fair values or cash flows of hedged items. Realized and unrealized gains or losses associated with derivative instruments which have been terminated or cease to be effective prior to maturity are recognized in the period in which they have been terminated or cease to be effective.

ASSET RETIREMENT OBLIGATIONS

When it can be reasonably determined, we recognize the fair value of a liability for any legal obligations associated with the retirement of long-lived assets when those obligations result from the acquisition, construction, development or normal operation of the assets. A corresponding asset retirement cost is added to the carrying amount of the related asset and depreciated or amortized to expense on a systematic and rational basis.

Certain of our vessels contain undetermined amounts of asbestos. Under certain circumstances, we may be required to handle and dispose of the asbestos in a manner required by regulations. It is our intention to sell decommissioned vessels into world markets to buyers who will keep them in active service. Under these circumstances asbestos remediation would become the responsibility of the new owner.

No amount has been recorded for asset retirement obligations relating to these assets as it is not possible to make a reasonable estimate of the fair value of any such liability due to the indeterminate magnitude, likelihood, or financial impact, if any, of this issue. In addition, as our operations are regulated, there is a reasonable expectation that any significant asset retirement costs would be recoverable through future tariffs.

ADOPTION OF NEW ACCOUNTING STANDARDS

We have adopted IFRS with a changeover date of April 1, 2012. Prior year comparatives have been restated under IFRS from our transition date of April 1, 2011. Note 28 to the audited consolidated financial statements contains a reconciliation of key components of our financial statements previously prepared under CGAAP to those prepared under IFRS as at and for the year ended March 31, 2012 and as at our transition date of April 1, 2011. The significant accounting policy changes are as follows:

- Rate-regulated operations: IFRS does not currently provide any guidance with respect to accounting for rate-regulated activities. In September 2010, the IASB staff released Agenda Paper 12 on rate-regulated activities. In their opinion, while the impact of regulators may have an economic impact on entities subject to rate-regulation:
  - Regulatory assets do not meet the definition of a financial asset or the definition of an intangible asset as specified in IAS 38; and
  - Regulatory liabilities do not meet the definition of a financial liability or the definition of a provision as specified in IAS 37.

It is our expectation that issues regarding rate-regulated activities will remain unresolved for some time and that we will not be reporting our regulatory assets or liabilities on the IFRS Statements of Financial Position. Accordingly, balances at March 31, 2011 of $3.7 million of current regulatory assets and $1.6 million of long-term regulatory liabilities were derecognized on our transition date of April 1, 2011 with a net reduction in retained earnings of $2.1 million.

As future balances of our regulatory accounts are uncertain, we cannot reasonably estimate and determine the impact on our future financial position and financial performance with respect to accounting for rate-regulated activities.

- Property, plant and equipment:
  - *Major overhauls and inspections:* The capitalization of major overhauls and inspections of our vessels is a significant change affecting us. We have defined, identified, quantified and reclassified major overhaul and inspection items for each class of vessel at transition date.

    This change has the potential to cause significant differences in earnings over the reporting periods due to the level of major overhauls and inspections in any one period and the number of periods over which each will be amortized. Over the five years ending March 31, 2016, we estimate the net impact of this change to range from a decrease in annual net earnings of $1 million to an increase in annual net earnings of $14 million.
  - *Valuation subsequent to transition:* We had a choice under IFRS to value our property, plant and equipment using either a historical cost model or a revaluation model. We decided to use a historical cost model for all property, plant and equipment with the exception of land. We are using a revaluation model for our land assets. At March 31, 2012, we recorded a revaluation reserve of $2.2 million to recognize a further increase in land values subsequent to transition.
  - *Other rate-regulated impacts:* As a rate-regulated entity and prior to transitioning to IFRS, we capitalized some costs such as feasibility, research and training that directly related to a specific asset. Under IFRS these costs are no longer capitalized. Over the five years ending March 31, 2016, we estimate the net impact to be a decrease in earnings of up to $2 million annually.
- IFRS 1 *First-Time Adoption of IFRS:* All elections and exemptions under IFRS 1 have resulted in a net increase of $8.6 million in retained earnings on transition. The elections and exemptions that applied to us upon adoption are summarized as follows:
  - *Employee Benefits:* There was a choice to either recognize all cumulative actuarial gains and losses of defined benefit plans through opening retained earnings or recalculate the actuarial gains and losses under IFRS from the inception of the defined benefit plans. We elected to recognize all cumulative actuarial gains and losses through opening retained earnings at April 1, 2011. The actuarial loss recognized in opening retained earnings was $3.6 million.
  - *Property, plant and equipment and Intangible assets:* There was a choice of valuation of property, plant and equipment and intangible assets at April 1, 2011, either to:
    - retrospectively apply IFRS to the valuation of the assets;
    - revalue items, on an asset by asset basis, at fair value and use that fair value as deemed cost; or
    - use previous GAAP carrying amounts at transition as the deemed cost for assets used in rate-regulated operations as detailed in the amendment to IFRS 1 published May 6, 2010.

We elected to use previous GAAP carrying amounts at transition as the deemed cost for all intangible assets and the majority of our property, plant and equipment with the exception of land. We elected to revalue land at fair value at April 1, 2011. This revaluation resulted in an increase in land value of $12.2 million.

FUTURE ACCOUNTING CHANGES

The following is a discussion of mandatory accounting changes that will be effective for us in accounting periods after March 31, 2013.

IAS 19 *Employee Benefits* has been amended and becomes effective for us on April 1, 2013. As a result of the amendments, actuarial gains and losses will be immediately recognized in other comprehensive income rather than net earnings and the option to use the corridor approach to recognize these costs over time will no longer be available. The amendments also introduce the net interest approach where the discount rate used to measure the obligation is applied to the net defined benefit liability (asset). In addition, the amendments change the definition of both short-term and long-term employee benefits so it is clear that the distinction between the two depends on when we expect the benefits to become due to be settled. We do not expect the application of this amended standard to have a material impact on our consolidated financial statements.

IFRS 9 *Financial Instruments (2010)* replaces the guidance in IAS 39 *Financial Instruments: Recognition and Measurement*, on the classification and measurement of financial assets. Financial assets will be classified into one of two categories on initial recognition: financial assets measured at amortized cost, or financial assets measured at fair value. We intend to adopt IFRS 9 *(2010)* in our financial statements for the annual period beginning on April 1, 2015. We do not expect the application of this standard to have any impact on our consolidated financial statements.

IFRS 13 *Fair Value Measurement* replaces the fair value measurement guidance contained in individual IFRSs with a single source of fair value measurement guidance. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. We intend to adopt IFRS 13 prospectively in our financial statements for the annual period beginning on April 1, 2013. We do not expect IFRS 13 to have a material impact on our consolidated financial statements.

Corporate Structure and Governance

National Instrument 58-101 *Disclosure of Corporate Governance Practices* (the "Instrument") and a related National Policy 58-201 *Corporate Governance Guidelines* (the "Guidelines") issued by the Canadian Securities Administrators require reporting issuers to disclose annually their approach to corporate governance with reference to specific matters. See Schedule A for the disclosure in accordance with this Instrument.

Forward Looking Statements

This Management's Discussion and Analysis contains certain "forward looking statements". These statements relate to future events or future performance and reflect management's expectations regarding our growth, results of operations, performance, business prospects and opportunities and industry performance and trends. They reflect management's current internal projections, expectations or beliefs and are based on information currently available to management. Some of the market conditions and factors that have been considered in formulating the assumptions upon which forward looking statements are based include traffic, the Canadian Dollar relative to the US Dollar, fuel costs, construction costs, the state of the local economy, fluctuating financial markets, demographics, tax changes, and the requirements of the CFSC.

Forward looking statements included in this document include statements with respect to: economic conditions, traffic levels, and fuel prices; positive net earnings for fiscal 2014, and our expectations of the impact of our cost containment program; whether our regulatory assets are probable of future recovery; our short-term and long-range business plans, capital expenditure levels, and asset renewal programs for vessels and terminals; our customer service program, payroll system replacement initiative, infrastructure relocation program, cable ferry initiative, LNG plans, and safety and training projects; our expectations regarding vacation package sales, and growth in drop trailer traffic; our expectations regarding our lack of need to access capital markets in the near term except to refinance maturing bonds, and how our operational cash requirements will be met; the additional payments to be received from the Province over the following four fiscal years, the amount of savings to be achieved through service level adjustments, and the Province's role regarding service levels and a long-term vision for connecting coastal communities; and our expectations regarding the impacts of Bill 14, Bill 20, Bill 47, and IFRS. In some cases, forward looking statements can be identified by terminology such as "may", "will", "should", "expect", "plan", "anticipate", "believe", "estimate", "predict", "potential", "continue" or the negative of these terms or other comparable terminology. A number of factors could cause actual events or results to differ materially from the results discussed in the forward looking statements. In evaluating these statements, prospective investors should specifically consider various factors including, but not limited to, the risks and uncertainties associated with traffic volume and tariff revenue risk, safety and security, asset risk, accident risk, tax risk, environmental risk, regulatory risk, labour disruption risk, limitations of vessel repair facilities, risk of default under material contracts and aboriginal land claims.

Actual results may differ materially from any forward looking statement. Although management believes that the forward looking statements contained in this Management's Discussion and Analysis are based upon reasonable assumptions, investors cannot be assured that actual results will be consistent with these forward looking statements. These forward looking statements are made as of the date of this Management's Discussion and Analysis, and British Columbia Ferry Services Inc. assumes no obligation to update or revise them to reflect new events or circumstances except as may be required by applicable law.

In addition to providing measures prepared in accordance with IFRS, we present certain supplemental non-IFRS measures. These include, but are not limited to, total comprehensive (loss) income adjusted for the effect of rate regulation, vehicle and passenger traffic, on-time performance, fleet reliability score, capacity provided and utilized, average tariff per vehicle and average tariff per passenger. These measures do not have any standardized meaning prescribed by IFRS and therefore are unlikely to be comparable to similar measures presented by other companies. These supplemental non-IFRS measures are provided to assist readers in determining our ability to generate cash from operations and improve the comparability of our results from one period to another. We believe these measures are useful in assessing operating performance of our ongoing business on an overall basis.

Schedule A

CORPORATE STRUCTURE AND GOVERNANCE

BOARD OF DIRECTORS

British Columbia Ferry Services Inc. ("BCFS" or the "Company") is subject to the *Business Corporations Act – British Columbia* and the *Coastal Ferry Act – British Columbia* (CFA). The board of directors (board) of BCFS is appointed by the Company's sole voting shareholder, B.C. Ferry Authority ("BCFA" or the "Authority").

During the fiscal year ended March 31, 2013, the board was composed of the following directors:

Chair: Donald P. Hayes

Members: Holly A. Haston-Grant, Guy D. Johnson, Brian G. Kenning, Gordon R. Larkin, Maureen V. Macarenko, P. Geoffrey Plant (vice chair), Wayne H. Stoilen and Graham M. Wilson

P. Geoffrey Plant was appointed vice chair of the board effective June 16, 2012. Guy D. Johnson was appointed a director effective August 25, 2012.

Jane M. Bird and John A. Horning were appointed directors effective April 1, 2013.

The directors are stewards of BCFS and set the strategic direction of the Company. The board exercises its stewardship responsibilities by overseeing the conduct of the business, supervising management, which is responsible for the day-to-day conduct of the business, and endeavouring to ensure that all major issues affecting the business and affairs of the Company are given proper consideration.

The board governance manual articulates the governance framework under which the board fulfills its stewardship responsibilities. The manual assembles in one document the essential elements for providing an appropriate level of governance for the organization. It includes, among other things, terms of reference for the board, chair, directors, committees, and committee chairs, and serves as a practical guide for the board and management in fulfilling their respective duties and responsibilities. The governance manual is a product and responsibility of the board.

The board is committed to the principles of independence and accountability. The board has adopted policies and practices that ensure it has the capacity, independent of management, to fulfill the board's responsibilities, make objective assessments of management, and assess the merits of management initiatives. The Governance & Nominating Committee has an ongoing responsibility to ensure that the governance structures and processes continue to enable the board to function independently.

The board and management recognize that there is a regular need for the board to meet without management in attendance. It is general practice to conduct a portion of every board and committee meeting with no members of management in attendance.

The board and its committees each have the authority to retain any outside advisor, at the Company's expense, that it determines to be necessary to permit it to carry out its duties.

The recruitment of directors is undertaken with the objective of ensuring the board is composed of a majority of strong, qualified, independent directors. The board supports the concept that the board chair should be an independent director.

The board has adopted a definition of an independent director for members of the Audit & Finance Committee consistent with the definition of independence in Multilateral Instrument 52-110. This definition, with some modification that is consistent with Multilateral Instrument 52-110, also applies to determining the independence of other members of the board.

The board is responsible for determining whether directors are independent pursuant to the definition of independence adopted by the board. To do this, the board requires members to disclose their relationships with the Company and its subsidiaries. These disclosures are reviewed by the corporate secretary, the chair of the Governance & Nominating Committee, and the chair of the board. Any director who is deemed independent, and whose circumstances change such that he or she might be considered to no longer be an independent director, is required to promptly advise the board of the change in circumstances. Directors are required annually to attest to their independence in writing.

All of the directors of the Company in the fiscal year were determined by the board to be independent pursuant to the definition of independence adopted by the board.

DIRECTORSHIPS

The following are directors of a reporting issuer (or the equivalent) in Canada or a foreign jurisdiction, other than BCFS:

Donald P. Hayes:	Director, Prima Colombia Hardwood Inc.
Guy D. Johnson:	Director, Sirius XM Canada Holdings Inc.
Brian G. Kenning:	Director, MacDonald Dettwiler & Associates Inc. Director, Royal Oak Ventures
Graham M. Wilson:	Director, ITRON Inc. Director, Naikun Wind Energy Group Inc. Director, Hardwoods Distribution Inc.

ORIENTATION AND CONTINUING EDUCATION

The Company has a variety of orientation and education programs in place for directors. These programs are aimed at increasing the directors' familiarity with the operation of the Company and its governance practices.

All new directors are provided with the opportunity to participate in an orientation program. The orientation program is tailored to the individual director's needs and areas of interest. The program generally involves a half to full day session, usually held prior to a new director attending his/her first BCFS board meeting, during which the new director is briefed by members of senior management, and receives written information about the business and operations of BCFS and board governance practices, including the duties and obligations of directors. The board governance manual is made available to all directors. This manual provides a comprehensive overview of the roles and responsibilities of the board, its committees, and the contributions expected by each director.

The board recognizes the importance of ongoing director education and the need for each director to take personal responsibility for this process. To facilitate ongoing education, presentations are made to directors from time to time on matters of particular importance or emerging significance to the Company. As well, attendance by directors at seminars, courses or conferences of relevance to their position as directors of the Company may be arranged. Visits by directors to BCFS facilities and operations are also encouraged and serve to further enhance the directors' ongoing knowledge and understanding of the Company.

Responsibility for ensuring that orientation and ongoing education are provided to directors rests with the chair of the board. The Governance & Nominating Committee has responsibility for reviewing the orientation and education programs to ensure they are effective and meet the needs of directors.

ETHICAL BUSINESS CONDUCT

The board approved and adopted a Code of Business Conduct and Ethics (code) in November 2004; the code was subsequently reviewed and amended by the board in November 2009. Notice of adoption, and subsequent amendment of the code as company policy, was communicated to the Company's personnel by intra-company information bulletin and BCFS' newsletter for personnel. In addition, the code has been posted on the Company's intranet website for Company personnel, and on the Company's internet site. The code was filed on SEDAR on March 1, 2006; the amended code was filed on November 24, 2009. The board has also adopted a Corporate Disclosure and Securities Trading Policy and a Corporate Communications Policy, both of which are also posted on the Company's intranet and internet sites.

As part of the Company's disclosure controls process, in conjunction with quarter-end financial reporting, appropriate managers are required to make representations regarding compliance with the code, the Corporate Disclosure and Securities Trading Policy and the Corporate Communications Policy.

As part of the communication process for the reporting of questionable accounting and auditing matters, a secure telephone line and a secure e-mail address, each monitored by the executive director of internal audit, as well as a secure e-mail address monitored by the chair of the Audit & Finance Committee of the board, have been established and this has been communicated to Company personnel by intra-Company information bulletin and BCFS' newsletter for personnel. The contact particulars are also posted with the code on the Company's intranet site.

The board, through the Audit & Finance Committee, monitors compliance with the code through review of compliance reports received quarterly from management, the external auditors, and the internal auditors.

Directors and officers review the code, and acknowledge their support and understanding of the policy by signing an annual disclosure statement.

The code requires that directors and officers disclose potential conflicts of interest at the time of their appointment and immediately upon a situation of a conflict of interest or potential conflict of interest arising. Such disclosures are communicated to and reviewed by the corporate secretary, the chair of the Governance & Nominating Committee, and the chair of the board.

NOMINATION OF DIRECTORS

The CFA requires that when electing directors to the board of BCFS, BCFA must select individuals in such a way as to ensure that, as a group, the directors of BCFS are qualified candidates, who hold all of the skills and all of the experience needed to oversee the operation of BCFS in an efficient and cost effective manner. On the recommendation of the BCFS board, the board of BCFA approves a profile setting out the skills, experience and expertise that should be represented on the BCFS board (skills profile). The board of BCFS nominates qualified candidates for election as directors and recommends to BCFA the size of the BCFS board.

The Governance & Nominating Committee has responsibility for the director nomination process. The committee is composed entirely of directors who are independent, pursuant to the definition of independence adopted by the board of BCFS, and operates under terms of reference adopted by the board.

The skills, experience, and expertise of the incumbents and any retiring directors of BCFS are reviewed by the Governance & Nominating Committee in the context of the skills profile approved by the BCFA board, and the ongoing governance needs of BCFS. Any gaps are identified. Potential conflicts of interest and other extenuating circumstances are also identified.

The Governance & Nominating Committee makes recommendations to the BCFS board on suitable candidates for appointment to the BCFS board. These recommendations take into consideration the talents of the existing BCFS Board and those of the nominees, taking the skills profile established for the BCFS Board, including knowledge of or presence in the communities served by BCFS, into account.

The BCFS board makes its decision on prospective directors and forwards its recommendations to the BCFA board. The BCFA board then determines the directors of BCFS and causes BCFA, as the sole holder of the single issued voting share of BCFS, to elect such individuals to the board of BCFS.

EXECUTIVE COMPENSATION

The Human Resources & Compensation Committee is responsible for reviewing and making recommendations to the BCFS board on executive compensation.

EXECUTIVE COMPENSATION PLAN

The CFA requires that the compensation of certain executive officers of BCFS be set and administered within a remuneration limit prescribed by an executive compensation plan. BCFA is responsible under the CFA for approving an executive compensation plan and any amendments to such plan.

In the fiscal year ended March 31, 2012, upon the recommendation of the BCFS board, BCFA approved an executive compensation plan with an effective date of October 1, 2011. The plan describes the philosophy for BCFS executive compensation and the maximum remuneration that individuals whose compensation is governed by such plan can receive in any fiscal year. The remuneration limits set out in the executive compensation plan were established with the assistance of an independent third-party compensation expert and with reference to the CFA, which requires that the remuneration under an executive compensation plan be consistent with the remuneration provided to individuals who, in organizations in Canada that are of a similar size and scope to BCFS, perform similar services or hold similar positions to that member of executive of BCFS, and not be greater than the remuneration that provincial public sector employers in British Columbia provide to individuals who, in those organizations, perform similar services or hold similar positions to that member of executive of BCFS.

Consistent with the CFA and *Miscellaneous Statutes Amendment Act No. 3 – 2010* (Bill 20), the approved executive compensation plan presently governs the remuneration the Company may provide to its current President & CEO, but not the remuneration of any other current executive officer so long as that individual remains in his current position.

EXECUTIVE COMPENSATION PROCESS

On an annual basis, the board, led by the Human Resources & Compensation Committee sets the performance requirements for the President & CEO and evaluates his performance against those requirements. Incentive pay for the President & CEO, which has a maximum target, is determined based on the evaluation results and the available room under the total remuneration limit set for the position in the executive compensation plan. With the assistance of the independent, third-party compensation expert, the Human Resources & Compensation Committee periodically reviews the remuneration limit set in the executive compensation plan in conjunction with market data from appropriate comparator organizations, and provides advice to the board on possible changes to the plan for recommendation to BCFA. Changes in the President & CEO's remuneration, if any, are made in consideration of his performance, leadership skills, retention risk, and value to achieving corporate strategy, and in accordance with the executive compensation plan approved by BCFA.

The board, led by the Human Resources & Compensation Committee, evaluates each of the other executive officers annually with respect to the achievement of annual performance objectives set by the President & CEO. The evaluation results are used to determine their incentive pay, which has maximum targets. Changes, if any, to the compensation of these executive officers are made in consideration of the individual's performance, leadership skills, retention risk, and value to achieving corporate strategy, and in conjunction with market compensation data obtained by the independent third-party compensation expert.

On an annual basis, the President & CEO formally assesses the development of each of the other executive officers, as well as other executive members. The President & CEO uses these assessments to design and update succession plans for all senior executive positions, including the position of President & CEO. These plans are reviewed by the Human Resources & Compensation Committee on an annual basis. With respect to all executive officers, succession planning is an important issue that receives ongoing and regular attention by the board and the President & CEO of the Company.

DIRECTOR COMPENSATION

The CFA requires that the compensation of directors of BCFS be set and administered within a remuneration limit prescribed by a directors' compensation plan. The BCFA is responsible under the CFA for approving a directors' compensation plan and any amendments to such plan. The remuneration provided under such a plan must be consistent with the remuneration that organizations in Canada that are of a similar size and scope to BCFS provide to their Directors, and not be greater than the remuneration that provincial public sector organizations in British Columbia provide to their directors.

In the fiscal year ended March 31, 2011, upon the recommendation of the BCFS board, BCFA approved a directors' compensation plan with an effective date of October 1, 2010. The plan was developed with the assistance of an independent third-party compensation expert and describes the philosophy for BCFS director compensation and the remuneration that can be provided to BCFS directors. Remuneration for directors of BCFS was amended and set by the Authority effective October 1, 2010, in accordance with the approved BCFS directors' compensation plan.

The Governance & Nominating Committee reviews director compensation regularly and provides advice to the board on any amendments to the directors' compensation plan to be recommended to BCFA.

PROTOCOL AGREEMENT

The Authority and BCFS have entered into a protocol agreement which clarifies and confirms their respective roles and responsibilities in relation to the authority of BCFA as shareholder of BCFS and the matters set forth in the CFA respecting the appointment and remuneration of BCFS directors and the remuneration of certain executive officers of BCFS.

BOARD COMMITTEES

The board has developed guidelines for the establishment and operation of committees of the board. Each committee operates according to a specific mandate approved by the board. The committee structure is set out below. The board chair is an ex-officio (non-voting) member of each of the Committees.

AUDIT & FINANCE COMMITTEE:

Members during the fiscal year ended March 31, 2013:

Chair: Brian G. Kenning

Members: Guy D. Johnson, P. Geoffrey Plant and Graham M. Wilson

Guy D. Johnson was appointed a member of the committee effective November 17, 2012.

The Audit & Finance Committee is appointed by the board to assist the board in fulfilling its oversight responsibilities. The committee has the mandate to:

- review the financial reports and other financial information provided by the Company to its security holders;
- review the annual operating and capital budgets, modifications thereto, and details of any proposed financing;
- monitor the integrity of the financial reporting process and the system of internal controls that the board and management have established;
- monitor the management of the principal risks that could impact the financial reporting of the Company, and the Company's compliance with legal and regulatory requirements as they relate to the Company's financial statements;
- review and approve the audit plan, process, results, and performance of the Company's external auditors and the internal audit department (the internal auditor) while providing an open avenue of communication between the board, management, external auditors, and the internal auditor; and
- assess the qualifications and independence of the external auditors, and recommend to the board the nominations of the external auditors and the compensation to be paid to the external auditors.

The committee has the authority to conduct any investigation appropriate to fulfilling its responsibilities, and it has direct access to the external auditors as well as anyone in the organization. The committee has the authority to retain special legal, accounting, and other advisors or experts it deems necessary in the performance of its duties.

Each of the members of the committee has been determined by the board to be independent, that is, without any direct or indirect relationship with the Company that could reasonably interfere with the exercise of the member's independent judgment.

All members of the committee are financially literate within the meaning of Multilateral Instrument 52-110, that is, each has the ability to read and understand a set of financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of the issues that can reasonably be expected to be raised by the Company's financial statements.

Since April 2, 2003, all recommendations of the committee to nominate or compensate an external auditor have been adopted by the board.

The aggregate fees billed by the Company's external auditor in each of the last two fiscal years were:

Years ended March 31 ($ thousands)	2013	2012
External Auditor billings		
Audit and audit related	173.5	157.8
Tax services	2.2	2.2
IFRS advisory services	7.1	19.7
Accounting advisory and forensic data analytics	1.2	4.5
	184.0	184.2

Pursuant to its terms of reference, the committee must pre-approve retaining the external auditors for any non-audit service to be provided to the Company or its subsidiaries, provided that no approval shall be provided for any service that is prohibited under the rules of the Canadian Public Accountability Board or the Public Company Accounting Oversight Board, or the Independence Standards of the Canadian Institute of Chartered Accountants.

Before retaining the external auditors for any non-audit service, the committee must consider the compatibility of the service with the external auditors' independence. The committee may pre-approve retaining of the external auditors for the engagement of any non-audit services by establishing policies and procedures to be followed prior to the appointment of the external auditors for the provision of such services. To date, no such policies and procedures have been established. In addition, the committee may delegate to one or more members the authority to pre-approve retaining of the external auditors for any non-audit services to the extent permitted by applicable law.

SAFETY, HEALTH, ENVIRONMENT & SECURITY COMMITTEE:

Members during the fiscal year ended March 31, 2013:

Chair: Wayne H. Stoilen

Members: Holly A. Haston-Grant, Gordon R. Larkin and Maureen V. Macarenko

The Safety, Health, Environment & Security Committee is appointed by the board to assist the board in fulfilling its oversight responsibilities. The committee has the mandate to:

- exercise due diligence over the safety, health, environmental, and security operations of the Company;
- develop, review, and make recommendations, as required, on matters related to the Company's safety, health, environmental, and security policies and practices; and
- monitor compliance with government regulations and with the Company's commitment to excellence on these issues.

GOVERNANCE & NOMINATING COMMITTEE:

Members during the fiscal year ended March 31, 2013:

Chair: P. Geoffrey Plant

Members: Gordon R. Larkin and Wayne H. Stoilen

P. Geoffrey Plant was appointed chair of the committee effective June 16, 2012.

The Governance & Nominating Committee is appointed by the board to assist the board in fulfilling its oversight responsibilities with respect to ensuring that the corporate governance system of BCFS is effective. The committee has the mandate to:

- review, assess, and make recommendations regarding the effectiveness of the policies and practices of the board;
- ensure the board's continuing ability to fulfill its legislative mandate;
- implement effective due diligence over the operations of the Company;
- make recommendations on the skills, experience and expertise that board members collectively and individually should have in order to oversee the operation of BCFS in an efficient and cost effective manner;
- establish and implement effective processes for identifying and recommending suitable candidates for appointment as directors of BCFS; and
- make recommendations on the remuneration of directors of BCFS.

HUMAN RESOURCES & COMPENSATION COMMITTEE:

Members during the fiscal year ended March 31, 2013:

Chair: Graham M. Wilson

Members: Holly A. Haston-Grant, Guy D. Johnson, Brian G. Kenning and Maureen V. Macarenko

Guy D. Johnson was appointed a member of the committee effective November 17, 2012.

The Human Resources & Compensation Committee is appointed by the board to assist the board in fulfilling its oversight responsibilities regarding the human resources and compensation strategies and policies of BCFS. The committee has the mandate to:

- regularly review, at a strategic level, the approach taken to manage the Company's human resources, including the recruitment, retention, motivation, and engagement of employees in the interests and success of the Company;
- regularly review the succession and development plans for the President & CEO and executive management; and
- review and recommend to the board a total compensation philosophy for the President & CEO and executive management that, subject to the CFA, attracts and retains executives, links total compensation to financial performance, and the attainment of strategic, operational, and financial performance, provides competitive total compensation opportunities at a reasonable cost, while enhancing the ability to fulfill the Company's overall strategies and objectives.

ASSESSMENTS

As part of its dedication to best governance practices, the board is committed to regular assessments of the effectiveness of the board, the board chair, committees, committee chairs, and individual directors.

The Governance & Nominating Committee annually reviews and makes recommendations to the board on the method and content for annual evaluations.

In the year ended March 31, 2013, the board engaged an independent consultant to coordinate the board evaluation. The consultant obtained the directors' views on matters related to the effectiveness of the board through the use of questionnaires and individual discussions with each director. The evaluation included an assessment of the performance of the board as a whole with respect to best practices in board governance, as well as a director self assessment and peer review related to best practices for board directors. The peer review results for each director were shared with the respective director and the chairs of the board and the Governance & Nominating Committee, and discussions on the results were held between the individual directors and the board chair. The results of the board evaluation, including the results of the peer reviews, were provided to the board, together with the consultant's recommendations for action. The board will consider the results and the recommendations in the upcoming year.

The performance of the board as a whole, and the performance of individual directors, is assessed regularly throughout the year. This occurs primarily through discussions between the individual directors and the board chair.

MANAGEMENT'S REPORT

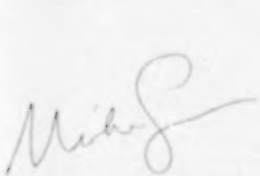
BC Ferries management is responsible for presentation and preparation of the annual consolidated financial statements, management's discussion and analysis ("MD&A") and all other information in this annual report.

The accompanying consolidated financial statements have been prepared in accordance with International Financial Reporting Standards. The consolidated financial statements and information in the MD&A necessarily include amounts based on management's informed judgements and best estimates. The financial information presented elsewhere in this annual report is consistent with that in the consolidated financial statements.

To meet its responsibility for reliable and accurate financial statements, management has established systems of internal control that are designed to provide reasonable assurance that assets are safeguarded from loss and that reliable financial records are maintained. These systems are monitored by management and by internal auditors. In addition, the internal auditors perform appropriate tests and related audit procedures.

The consolidated financial statements have been examined by KPMG LLP, independent chartered accountants. The external auditors' responsibility is to express a professional opinion on the fairness of management's consolidated financial statements. The auditors' report outlines the scope of their examination and sets forth their opinion.

The Board of Directors, through its Audit & Finance Committee, oversees management's responsibilities for financial reporting and internal control. The Audit & Finance Committee meets with the internal auditors, the independent auditors and management to discuss auditing and financial matters and to review the consolidated financial statements and the independent auditors' report. The Audit & Finance Committee reports its findings to the Board for consideration in approving the consolidated financial statements for issuance.



Michael J. Corrigan
President & Chief Executive Officer

Robert P. Clarke, CGA
Executive Vice-President & Chief Financial Officer

June 21, 2013
Victoria, Canada

To the Shareholders of British Columbia Ferry Services Inc.

We have audited the accompanying consolidated financial statements of British Columbia Ferry Services Inc., which comprise the consolidated statements of financial position as at March 31, 2013, March 31, 2012 and April 1, 2011 and the consolidated statements of comprehensive income (loss), changes in equity and cash flows for the years ended March 31, 2013 and March 31, 2012, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform an audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinions.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of British Columbia Ferry Services Inc. as at March 31, 2013, March 31, 2012, and April 1, 2011 and its consolidated financial performance and its consolidated cash flows for the years ended March 31, 2013 and March 31, 2012 in accordance with International Financial Reporting Standards.

KPMG LLP

Chartered Accountants

June 21, 2013
Victoria, Canada

British Columbia Ferry Services Inc.

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION (EXPRESSED IN THOUSANDS OF CANADIAN DOLLARS)

As at	March 31, 2013	March 31, 2012	April 1, 2011
Assets			
Current assets			
Cash and cash equivalents (note 3)	$ 36,641	$ 7,700	$ 33,335
Restricted short-term investments (note 4(e))	35,575	35,705	37,040
Other short-term investments	43,403	26,880	64,074
Trade and other receivables (note 6(a))	18,118	42,341	20,619
Prepaid expenses	10,706	6,725	5,648
Inventories (note 7)	23,257	22,016	19,957
	167,700	141,367	180,673
Non-current assets			
Long-term loan receivable (note 8)	24,515	24,515	24,247
Long-term land lease (note 9)	32,063	32,521	32,979
Property, plant and equipment (note 10)	1,552,062	1,596,507	1,593,194
Intangible assets (note 11)	47,942	41,758	34,929
	1,656,582	1,695,301	1,685,349
Total assets	$ 1,824,282	$ 1,836,668	$ 1,866,022
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities	$ 51,803	$ 50,708	$ 49,872
Short-term debt (note 4(d))	–	17,737	3,949
Interest payable on long-term debt	18,063	18,249	18,261
Deferred revenue	13,634	13,784	15,596
Derivative liabilities	12	12	23
Current portion of long-term debt (note 4)	149,000	9,000	22,125
Current portion of accrued employee future benefits (note 12)	2,204	2,204	1,351
Current portion of obligations under finance lease (note 8)	1,072	974	1,040
Provisions (note 13)	50,839	47,022	46,788
	286,627	159,690	159,005
Non-current liabilities			
Accrued employee future benefits (note 12)	16,604	17,361	17,091
Long-term debt (note 4)	1,137,212	1,285,232	1,327,014
Obligations under finance lease (note 8)	45,941	47,013	47,723
	1,199,757	1,349,606	1,391,828
Total liabilities	$ 1,486,384	$ 1,509,296	$ 1,550,833
Equity			
Share capital (note 15)	$ 75,478	$ 75,478	$ 75,478
Contributed surplus (note 16)	25,000	25,000	–
Retained earnings	234,187	224,717	239,711
Total equity before reserves	334,665	325,195	315,189
Land revaluation reserve (note 10(a) & 17)	3,233	2,177	–
Total equity including reserves	337,898	327,372	315,189
Total liabilities and equity	1,824,282	1,836,668	1,866,022

Commitments (note 10(b))

See accompanying notes to the consolidated financial statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (EXPRESSED IN THOUSANDS OF CANADIAN DOLLARS)

Years ended March 31	2013	2012
Revenue		
Vehicle and passenger fares	$ 468,780	$ 458,392
Ferry service fees (note 18)	182,100	158,261
Retail	76,496	76,522
Federal-Provincial Subsidy Agreement (note 19)	28,078	27,487
Fuel surcharges	11,469	13,098
Regulated other income (note 20)	12,848	13,768
Other income	6,602	6,266
Total revenue	786,373	753,794
Expenses		
Operations	436,812	433,157
Maintenance	69,938	65,926
Administration	29,632	31,187
Cost of retail goods sold	29,500	29,132
Depreciation and amortization	135,675	133,549
Total operating expenses	701,557	692,951
Operating profit	84,816	60,843
Net finance and other expenses		
Net finance expenses (note 22)		
Finance income	2,922	2,404
Finance expenses	(72,076)	(71,870)
Total net finance expenses	(69,154)	(69,466)
Loss on disposal of property, plant and equipment	(154)	(333)
Total net finance and other expenses	(69,308)	(69,799)
Net earnings (loss)	15,508	(8,956)
Other comprehensive income		
Gain on revaluation of land assets	1,056	2,177
Total other comprehensive income	1,056	2,177
Total comprehensive income (loss)	$ 16,564	$ (6,779)

See accompanying notes to the consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS (EXPRESSED IN THOUSANDS OF CANADIAN DOLLARS)

Years ended March 31	2013	2012
Cash flows from operating activities		
Net earnings (loss)	$ 15,508	$ (8,956)
Items not affecting cash		
Net finance costs recognized in net earnings	69,154	69,466
Depreciation and amortization of non-current assets	135,675	133,549
Loss on disposal of property, plant and equipment	154	333
(Decrease) increase in long-term accrued employee future benefits	(757)	304
Increase (decrease) in derivative liabilities	–	(11)
Increase in provisions	3,817	350
Other non-cash adjustments to property, plant & equipment	(791)	100
Decrease in long-term land lease	458	458
Increase in accrued net financing	246	689
Total non-cash items	207,956	205,238
Movements in operating working capital		
Decrease (increase) in trade and other receivables	24,223	(21,722)
Increase in prepaid expenses	(3,981)	(1,077)
Increase in inventories	(1,241)	(2,060)
Increase in accounts payable and accrued liabilities	1,095	836
Decrease in deferred revenue	(150)	(1,812)
Increase in current portion of accrued employee future benefits	–	702
Change in non-cash working capital	19,946	(25,133)
Change attributable to capital asset acquisitions	6,653	(9,378)
Change attributable to contributed surplus	(25,000)	25,000
Change in non-cash operating working capital	1,599	(9,511)
Cash generated from operating activities	225,063	186,771
Interest rate support received (note 22(a))	742	1,337
Interest received	2,268	1,922
Interest paid	(73,471)	(74,507)
Net cash generated by operating activities	$ 154,602	$ 115,523
Cash flows from financing activities		
Repayment of long-term debt	$ (9,000)	$ (55,875)
(Repayment of) proceeds from short-term debt	(17,737)	13,788
Repayment of finance lease obligations	(974)	(1,042)
Contributed surplus payment from Province	25,000	–
Dividends paid on preferred shares	(6,038)	(6,038)
Net cash used in financing activities	$ (8,749)	$ (49,167)
Cash flows from investing activities		
Proceeds from disposal of property, plant and equipment	$ 120	$ 118
Purchase of property, plant and equipment and intangible assets	(100,639)	(130,370)
Advance of long-term loan	–	(268)
Reduction of debt service reserve	130	1,335
(Purchase of) proceeds from short-term investments	(16,523)	37,194
Net cash used in investing activities	(116,912)	(91,991)
Net increase (decrease) in cash and cash equivalents	28,941	(25,635)
Cash and cash equivalents, beginning of year	7,700	33,335
Cash and cash equivalents, end of year	$ 36,641	$ 7,700

See accompanying notes to the consolidated financial statements

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY (EXPRESSED IN THOUSANDS OF CANADIAN DOLLARS)

	Share capital	Contributed surplus	Retained earnings	Total equity before reserves	Land revaluation reserve	Total equity including reserves
Balance as at April 1, 2011	$ 75,478	$ –	$ 239,711	$ 315,189	$ –	$ 315,189
Contribution from the Province	–	25,000	–	25,000	–	25,000
Net loss for the year ended March 31, 2012	–	–	(8,956)	(8,956)	–	(8,956)
Other comprehensive income for the year ended March 31, 2012	–	–	–	–	2,177	2,177
Preferred share dividends	–	–	(6,038)	(6,038)	–	(6,038)
Balance as at March 31, 2012	$ 75,478	$ 25,000	$ 224,717	$ 325,195	$ 2,177	$ 327,372
Net earnings for the year ended March 31, 2013	–	–	15,508	15,508	–	15,508
Other comprehensive income for the year ended March 31, 2013	–	–	–	–	1,056	1,056
Preferred share dividends	–	–	(6,038)	(6,038)	–	(6,038)
Balance as at March 31, 2013	$ 75,478	$ 25,000	$ 234,187	$ 334,665	$ 3,233	$ 337,898

See accompanying notes to the consolidated financial statements.

YEARS ENDED MARCH 31, 2013 AND 2012
(Expressed in thousands of Canadian dollars)

British Columbia Ferry Services Inc. (the "Company") was incorporated under the *Company Act (British Columbia)* by way of conversion on April 2, 2003, and now validly exists under the *Business Corporations Act (British Columbia)*. The Company's primary business activity is the provision of coastal ferry services in British Columbia.

The Company is subject to the *Coastal Ferry Act* (the "Act") as amended, which came into force on April 1, 2003. Its common share is held by the B.C. Ferry Authority (the "Authority"), a corporation without share capital, and it is regulated by the British Columbia Ferries Commissioner (the "Commissioner") to ensure that rates are fair and reasonable and to monitor service levels.

The Company's business is seasonal in nature, with the highest activity in the summer (second quarter) and the lowest activity in the winter (fourth quarter), due to the high number of leisure travellers and their preference to travel during the summer months. The Company also takes advantage of the low activity during the winter months to perform a significant portion of the required annual maintenance on vessels and terminals.

1. ACCOUNTING POLICIES:

(a) Basis of preparation:
British Columbia Ferry Services Inc. is a company domiciled in Canada. The address of the Company's registered office is Suite 500, 1321 Blanshard Street, Victoria, BC Canada, V8W 0B7. These consolidated financial statements of the Company as at and for the years ended March 31, 2013 and 2012 comprise the Company and its subsidiaries (together referred to as the "Group").

(b) Statement of compliance:
These consolidated financial statements represent the first annual statements of the Group prepared in accordance with International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB"). The Group adopted IFRS in accordance with *IFRS 1, First-time Adoption of International Financial Reporting Standards*. The first date at which IFRS was applied was April 1, 2011. In accordance with IFRS, the Group has:

- provided comparative financial information;
- applied the same accounting policies throughout all periods presented;
- retrospectively applied all effective IFRS standards as of April 1, 2011, as required; and
- applied certain optional exemptions and certain mandatory exceptions as applicable for first time IFRS adopters.

The Group's consolidated financial statements were previously prepared in accordance with accounting principles then generally accepted in Canada ("previous GAAP"). Previous GAAP differs in some areas from IFRS. In preparing these financial statements, management has amended certain accounting, measurement and consolidation methods previously applied in the previous GAAP financial statements to comply with IFRS. Note 28 contains reconciliations and descriptions of the effect of the transition from previous GAAP to IFRS on changes in equity, loss and total comprehensive loss along with reconciliations of the statement of financial position as at April 1, 2011 and March 31, 2012, and the statement of comprehensive loss for the year ended March 31, 2012.

These consolidated financial statements were approved by the Board of Directors on June 21, 2013.

(c) Basis of measurement:
These consolidated financial statements have been prepared using the historical cost method, with the exception of the following assets and liabilities which are measured at fair value: land, derivatives, financial instruments held for trading and available-for-sale financial assets.

(d) Functional and presentation currency:
These consolidated financial statements are presented in Canadian dollars ("Cdn") which is the Group's functional currency. All financial data is presented in Canadian dollars rounded to the nearest thousand.

(e) Use of estimates and judgements:
The preparation of consolidated financial statements in accordance with IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting methods and the amounts recognized in the financial statements. These estimates and the underlying assumptions are established and reviewed continuously on the basis of past experience and other factors considered reasonable in the circumstances. They therefore serve as the basis for making judgements about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from the estimates.

Significant estimates relate to:

(i) Property, plant and equipment and intangible assets
The calculation of depreciation and amortization involves estimates concerning the economic life and salvage value of property, plant and equipment and intangible assets.

(ii) Future employee benefits
Accounting for the costs of future employee benefits is based on actuarial valuations, relying on key estimates for discount rates, future salary increases, employee turnover rates and mortality tables.

Significant judgments relate to the provision for contingencies, including asset retirement obligations. In forming these judgments, the Group is required to consider the probability of future payments.

(f) Basis of consolidation – subsidiaries:
A subsidiary is an entity controlled by the Group. Control exists when the Group has the power to manage, either directly or indirectly, the entity's financial and operational policies in order to obtain benefits from its activities. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

The financial statements of all subsidiaries are prepared to the same reporting date as the Group using consistent accounting policies.

The subsidiary holdings of the Group as at March 31, 2013 (note 25) are:

- Pacific Marine Leasing Inc.
- BCF Captive Insurance Company Ltd.

All inter-Group transactions, balances and any unrealized income and expenses on inter-Group transactions are eliminated on consolidation.

(g) Foreign currency transactions:
Transactions denominated in foreign currencies are translated by applying the exchange rate prevailing on the date of the transaction. At each reporting date, all monetary assets and liabilities denominated in foreign currencies are translated into Cdn at the closing exchange rate. Any resulting translation adjustments are recorded in net earnings or loss.

(h) Property, plant and equipment:
Property, plant and equipment, excluding land assets, are valued at cost plus direct overhead and financing costs, less depreciation and impairment. Land is valued at fair value at each year-end using the annual assessed values for property tax purposes as being representative of the fair values of these assets.

The cost of self-constructed assets includes expenditures on materials, direct labour, financing costs and an allocated proportion of project overheads. When parts of an item of property, plant and equipment have different estimated useful lives, they are accounted for as separate items (major components) of property, plant and equipment. The cost of replacing an item of property, plant and equipment is recognized in the carrying amount of the item if it is probable that the future economic benefits embodied within the item will flow to the Group, and its cost can be measured reliably. The carrying amount of the replaced part is derecognized. Gains and losses on disposal of an item of property, plant and equipment are determined by comparing the proceeds from disposal with the carrying amount of the item of property, plant and equipment and are recognized in net earnings or loss. The costs of the day-to-day servicing of items of property, plant and equipment are recognized in net earnings or loss as incurred.

Where components of an asset have different estimated useful lives, depreciation is calculated on each separate component. Depreciation commences when an asset is available for use. Estimates of remaining useful lives and residual values are reviewed annually and adjusted if appropriate. Property, plant and equipment, including assets under finance leases, are depreciated on a straight-line basis over the estimated useful lives of the assets at the following rates:

Asset class	Estimated useful life
Vessel hulls	3 to 40 years
Vessel propulsion and utility systems	3 to 30 years
Marine structures	20 to 40 years
Buildings	20 to 40 years
Equipment and other	3 to 20 years

(i) Intangible assets:
Intangible assets consist of acquired computer software and licenses and rights of use as well as internally developed computer software and website. These assets are valued at their acquisition cost plus direct overhead and financing costs, less amortization and impairment.

Software costs are capitalized if it is probable that the asset created will generate future economic benefits, the costs can be reliably measured, the product is technically feasible and the Group intends to, and has sufficient resources to, complete development and use the asset. Website costs are capitalized where the expenditure is incurred on developing an income generating website. Software and website costs capitalized include materials, direct labour and financing costs. Subsequent expenditure is capitalized only if it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure, including expenditure on internally generated goodwill and brands, is recognized in net earnings or loss as incurred.

Intangible assets with finite useful lives are amortized on a straight line basis over their estimated useful lives (3 to 7 years) since this most closely reflects the expected pattern of consumption of future economic benefits embodied in the asset. Rights of use intangible assets are amortized on a straight-line basis over their estimated useful lives of 10 to 30 years. Amortization is recognized in net earnings or loss from the date that intangible assets are available for use. The amortization methods and estimated remaining lives are reviewed annually.

(j) Inventories:

Inventories are measured at the lower of cost and net realizable value. Net realizable value represents the estimated selling price for inventories less all estimated costs of completion and costs necessary to make the sale. No amounts are carried at net realizable value.

The cost of general and catering inventories is accounted for using the weighted average formula, while the cost of fuel inventories is based on the first-in–first-out principle. The cost of inventories includes expenditures incurred in acquiring the inventories and other direct costs incurred in bringing them to their existing location and condition.

(k) Employee benefits:

The Group has a number of defined benefit pension and post-retirement plans. The plans are generally funded by payments from employees and by the Group, taking into account the recommendations of independent qualified actuaries.

Defined contribution plan accounting is applied to the Group's multi-employer defined benefit pension and long-term disability plans. These multi-employer plans are administered by external parties and the Group does not have sufficient information to apply defined benefit plan accounting. The cost of these benefits is charged to net earnings or loss as contributions are made to the plans.

The actuarial determination of the accrued benefit obligations for retirement benefits uses the projected benefit method prorated on service (which incorporates management's best estimate of future salary levels, other cost escalation, retirement ages of employees and other actuarial factors). Under the projected benefit method, the cost of these benefits is charged to net earnings or loss so as to spread the regular cost over the service lives of employees in accordance with the advice of qualified actuaries who carry out a full valuation of the plans on a regularly scheduled basis. The pension obligation is measured as the present value of estimated future cash outflows using interest rates based on the yield of long-term high quality corporate bonds with maturities matching the pension obligation.

Assets are valued at fair value for the purpose of calculating the expected return on plan assets.

Actuarial gains (losses) arise from the difference between the actual long-term rate of return on plan assets for a period and the expected long-term rate of return on plan assets for that period and from changes in actuarial assumptions used to determine the accrued benefit obligation. For the Group's retirement bonus and death benefit plans, the excess of the net accumulated actuarial gain (loss) over 10 percent of the greater of the benefit obligation and the fair value of plan assets is amortized over the average remaining service period of active employees. The average remaining service period of the active employees covered by the retirement bonus and death benefit plans was 7.0 years as at March 31, 2011, the date of the most recent actuarial valuation.

Past service costs arising from plan amendments are recognized immediately to the extent that the benefits are already vested but are deferred and amortized on a straight-line basis over the average remaining service period of employees active at the date of amendment where the benefits are not already vested. The full liability for all plan deficits is recorded, as adjusted for any past service costs still to be amortized.

When the restructuring of a benefit plan gives rise to both a curtailment and a settlement of obligations, the curtailment is accounted for prior to the settlement.

(l) Provisions:

A provision is recorded when:

- the Group has a current obligation (legal or constructive) resulting from a past event; and
- it is likely that an outflow of resources representing economic benefits will be required to settle the obligation; and
- the amount of the obligation can be measured reliably.

If these conditions are not met, no provision is recorded.

Provisions are determined by discounting the expected future cash flows at a rate that reflects current market assessments of the time value of money and the risks specific to the liability. The unwinding of the discount is recognized as a finance expense.

(m) Revenues:

Tariff revenue is recognized when transportation is provided. The value of fares sold for which payment is received in advance of providing transportation is included in the statement of financial position as deferred revenue. These advance payments include prepaid vehicle and passenger fares, assured loading tickets and other reservation fees.

Retail revenue consists primarily of food services and gift shop sales. Parking revenues are received from both owned and subcontracted parking facilities and are recognized when service is provided. Revenue is generated from various advertising contracts and recognized according to the individual agreement.

Construction contract revenue is recognized using the percentage of completion method. At each reporting period, an estimate is made of the total profit or loss expected for the contract and the percentage of work completed. These estimates are used to measure the fair value of the consideration receivable for the contract and the amount of costs to be recognized in the period. If contract costs are not probable of being recovered they are immediately expensed.

(n) Finance leases:

Assets held under finance leases are initially recognized as assets of the Group at their fair value at the inception of the lease or, if lower, at the present value of the minimum lease payments.

Lease payments are apportioned between finance expenses and reduction of the lease obligation so as to produce a constant periodic rate of interest on the remaining balance of the liability.

(o) Operating leases:

Operating lease payments are recognized as an expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

(p) Taxes:

The Group is a "Tax Exempt Corporation" as described in the *Income Tax Act* and as such is exempt from federal and provincial income taxes.

The provision of vehicle and passenger ferry services is an exempt supply under the *Excise Tax Act* for HST/GST purposes.

(q) Impairment of non-financial assets:

Non-financial assets with finite lives, including property, plant and equipment and intangible assets, are tested for impairment when events or changes in circumstances indicate that their carrying amounts may not be recoverable.

The impairment charged to net earnings or loss is the excess of the carrying value over the recoverable amount. The recoverable amount is the higher of an asset's fair value less cost to sell or its value in use.

For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). The Group defines a cash generating unit as a route group. Price caps for each route group are set by the Commissioner based on the costs necessary to provide service on each route group as defined in the Coastal Ferry Services Contract with the Province of British Columbia (the "Province").

The Group evaluates impairment losses for potential reversals when events or changes warrant such consideration. An impairment is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined had no impairment been recognized. A reversal of impairment is charged to net earnings or loss.

(r) Financial assets and liabilities:

Financial assets include trade receivables, loan receivables, derivatives with a positive market value, investment in securities and cash.

Financial liabilities include bank borrowings, bonds, obligations related to lease contracts, derivatives with a negative market value and trade payables.

Financial assets and liabilities presented are "non-current" except those with a maturity of less than twelve months from the period-end date. Those with maturities of less than twelve months are presented as "current assets" or "cash equivalents" depending on the circumstances.

(i) *Recognition and measurement of financial assets (excluding derivatives)*
In accordance with IAS 39, "*Financial Instruments: Recognition and Measurement*", financial assets are classified into one of four categories:

- assets held-to-maturity (securities giving entitlement to fixed or fixable payments on set dates, and which the Group is able and intending to hold to maturity);
- loans and receivables (non-derivative financial assets subject to fixed or fixable payments, and which are not quoted on an active market);
- assets held-for-trading (investments and securities bought and held primarily with a view to a short-term resale); and
- assets held for sale (all financial assets not recognized in one of the three previous categories).

Classification depends on the nature and objective of each financial asset and is determined when first recognized.

(ii) *Loans and advances*
When initially recognized, loans and advances are measured at fair value. These financial assets are then carried at amortized cost using the effective interest rate method. Loans and advances are subject to recoverable value tests, carried out whenever there are objective indicators that the recoverable value of these assets would be lower than the carrying value and, at the very least, on each statement of financial position date.

(iii) *Trade and other receivables*
Trade and other receivables are recorded at fair value (in most cases the same as nominal value) minus any loss of value recorded in a special impairment account. As receivables are due in less than one year, they are not discounted. If there is any indication that these assets may be impaired, they will be subject to an analysis based primarily on the following criteria: age of the receivable, the debtor's financial position and negotiation of a payment schedule. The difference between the carrying amount and the recoverable value is recorded as a provision in net earnings or loss. Impairment may be reversed if the asset regains its value in future periods and the reversal is booked in the same item as the initial provision. Impairment is deemed permanent when the receivable itself is considered to be permanently non-recoverable and written off.

(iv) *Cash and cash equivalents*
Cash and cash equivalents include cash on hand and demand deposits, with a maturity of less than three months, are held to maturity and measured at amortized cost. Due to the nature of these financial instruments and/or short-term maturity of these financial instruments, carrying value approximates fair value. The instruments held in this category can be liquidated or sold on short notice, and do not bear any significant risk of loss in value.

(v) *Borrowings and other financial liabilities*
Trade and other debts are initially recorded at fair value, which is generally the same as nominal value. Bank borrowings and other financial liabilities are subsequently measured at amortized cost calculated using the effective interest rate method. Interest accrued on borrowings is included in "accounts payable and accrued liabilities" on the statement of financial position. Cash flows linked to short-term payable amounts are not discounted. Long-term cash flows are discounted whenever the impact is significant.

(vi) *Recognition and measurement of financial derivatives*
Financial derivatives are held from time to time to manage exposure to fuel price, interest rate and foreign exchange risks. Derivatives are initially recorded at fair value and associated transaction costs are booked in net earnings or loss when incurred. After initial recognition, derivatives are measured at fair value based on market prices at each statement of financial position date. Changes in the fair value of these instruments are recorded in net earnings or loss. The Group derecognizes a financial liability when its contractual obligations are discharged, cancelled or expired.

In estimating fair value, the Group uses quoted market prices when available. Models incorporating observable market data along with transaction specific factors are also used in estimating fair value. Financial assets and liabilities are classified in the fair value hierarchy according to the lowest level of observability of inputs that are significant to the fair value measurement. Assessment of the significance of a particular input to the fair value measurement requires judgment and may affect placement within the following fair value hierarchy levels:

- level 1 – quoted prices in active markets for identical assets or liabilities,
- level 2 – techniques (other than quoted prices included in level 1) that are observable for the asset or liability, either directly (as prices), or indirectly (as derived from prices), and
- level 3 – techniques which use inputs which have a significant effect on recorded fair values for the asset or liability that are not based on observable market data (unobservable inputs).

(s) Borrowing costs:

The Group capitalizes borrowing costs that are directly attributable to the acquisition, construction or production of qualifying assets, as a part of the cost of those assets, until such time as the assets are substantially ready for their intended use. The Group identifies a qualifying asset as one that necessarily takes six months or more to get ready for its intended use.

To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the Group capitalizes the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of these borrowings.

To the extent that the obtaining of a qualifying asset is funded by general borrowings, the Group determines the borrowing costs eligible for capitalization by applying the weighted average cost of borrowings for the period to the expenditures on that asset.

All other borrowing costs are recognized in net earnings or loss in the period in which they are incurred.

(t) Hedging relationships:

Derivative financial instruments are utilized by the Group to manage market risk against the volatility in foreign currency, interest rate, and fuel price exposures. The Group does not utilize derivative financial instruments for trading or speculative purposes. At the inception of each hedge the Group determines whether it will or will not apply hedge accounting.

When applying hedge accounting, the Group documents all relationships between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedge transactions. This process includes linking all derivatives to specific assets and liabilities on the statements of financial position or to specific firm commitments or forecasted transactions. The Group also assesses, both at the hedge inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are effective in offsetting changes in fair values or cash flows of hedged items. Realized and unrealized gains or losses associated with derivative instruments which have been terminated or cease to be effective prior to maturity are recognized in the period in which they have been terminated or cease to be effective. Realized hedge gains or losses are reclassified from other comprehensive income and are included in the initial carrying amount of the asset or liability acquired.

(u) Debt transaction costs:

Legal and financing costs incurred for arranging long-term debt are capitalized. Once the debt is issued these costs are reclassified from deferred costs to long-term debt which is measured using the effective interest rate method.

(v) Asset retirement obligations:

In the period when it can be reasonably determined, the Group recognizes a liability at its fair value for any legal obligations associated with the retirement of long-lived assets when those obligations result from the acquisition, construction, development or normal operation of the assets. A corresponding asset retirement cost is added to the carrying amount of the related asset and amortized to expense on a systematic and rational basis.

It is possible that the Group's estimates of its ultimate asset retirement obligations could change as a result of changes in regulations, changes in the extent of environmental remediation required, changes in the means of reclamation or changes in cost estimates. Changes in estimates are accounted for prospectively from the period the estimate is revised.

The Group's long-lived assets include certain vessels which contain undetermined amounts of asbestos. Under certain circumstances the Group may be required to handle and dispose of the asbestos in a manner required by regulations. It is the Group's intention to sell decommissioned vessels into world markets for continued use in providing commercial ferry service. Under these circumstances asbestos remediation would become the responsibility of the new owner.

No amount has been recorded for asset retirement obligations relating to these assets as it is not possible to make a reasonable estimate of the fair value of any such liability due to the indeterminate magnitude, likelihood or financial impact, if any, of this issue.

(w) Interest rate support:

The Group receives interest rate support from the Government of Canada for eligible new Canadian built vessels or major refurbishment of vessels. Amounts receivable in regard to capitalized interest are recognized as a reduction of capitalized interest upon completion of the project. Amounts receivable in regard to post-completion debt service costs are recognized as a reduction to interest expense.

(x) Comprehensive income:

The Group recognizes increases in the fair values of land assets in other comprehensive income except to the extent that such an increase represents a reversal of a decrease for the same asset that was previously recognized in profit or loss.

A decrease in the fair values of land assets is recognized in profit or loss to the extent the decrease exceeds the balance, if any, held in the land revaluation reserve relating to a previous revaluation.

(y) Segment reporting:

The Group operates within a single industry and within a single geographical area. All review of operating results and decisions about resources to be allocated are done at a corporate level. Accordingly no segment reporting is presented in these consolidated financial statements.

(z) Comparative figures:

Certain comparative figures have been reclassified to conform to the presentation adopted for the current period. As at March 31, 2013 the Group reclassified $2.9 million (2012: $3.5 million; 2011: $2.7 million) from provisions to employee future benefits. This is the value of a supplemental executive retirement plan which was reclassified to be consistent with classification of the Group's other retirement plans.

2. FUTURE ACCOUNTING CHANGES:

Certain pronouncements were issued by the IASB that are mandatory for accounting periods after March 31, 2013.

(a) IAS 19 *Employee Benefits*:

This standard has been amended to make certain changes to the recognition, presentation and disclosure of defined benefit plans, and becomes effective for the Group beginning April 1, 2013. As a result of these amendments, actuarial gains and losses of defined benefit plans will be immediately recognized in other comprehensive income instead of profit and loss. The option to use the corridor approach to recognize these costs over time will no longer be available. The amendments also introduce the net interest approach to disaggregate defined benefit costs. This is calculated by applying the discount rate used to measure the obligation to the net defined benefit liability (asset). In addition, the amendments change the definition of both short-term and long-term employee benefits so it is clear that the distinction between the two depends on when the entity expects the benefits to become due to be settled. The Group does not expect the application of this amended standard to have a material impact on its consolidated financial statements.

(b) IFRS 9 *Financial Instruments (2010)*:

This standard replaces the guidance in IAS 39 Financial Instruments: Recognition and Measurement, on the classification and measurement of financial assets. The Standard eliminates the existing IAS 39 categories of held to maturity, available-for-sale and loans and receivables. Financial assets will be classified into one of two categories on initial recognition: financial assets measured at amortized cost; or financial assets measured at fair value. The Group intends to adopt IFRS 9 (2010) in its financial statements for the annual period beginning on April 1, 2015. The Group does not expect the application of this amended standard to have any impact on its consolidated financial statements.

(c) IFRS 13 *Fair Value Measurement*:

This standard replaces the fair value measurement guidance contained in individual IFRSs with a single source of fair value measurement guidance. It defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Group intends to adopt IFRS 13 prospectively in its financial statements for the annual period beginning on April 1, 2013. The Group does not expect IFRS 13 to have a material impact on its consolidated financial statements.

3. CASH AND CASH EQUIVALENTS:

As at March 31	2013	2012
Cash	19,043	4,034
Cash equivalents:		
Held-for-trading investments	93	1,457
Held-to-maturity investments	17,505	2,209
Total	36,641	7,700

4. LOANS:

As at March 31	2013	2012
Long-term debt		
5.74% Senior Secured Bonds, Series 04-1, due May 2014 (effective interest rate of 5.92%)	250,000	250,000
6.25% Senior Secured Bonds, Series 04-4, due October 2034 (effective interest rate of 6.41%)	250,000	250,000
5.02% Senior Secured Bonds, Series 07-1, due March 2037 (effective interest rate of 5.06%)	250,000	250,000
5.58% Senior Secured Bonds, Series 08-1, due January 2038 (effective interest rate of 5.62%)	200,000	200,000
6.21% Senior Secured Bonds, Series 08-2, due December 2013 (effective interest rate of 6.33%)	140,000	140,000
12 Year Loan, maturing March 2020		
Tranche A (effective interest rate of 5.17%)	52,500	60,000
Tranche B (floating interest rate of 1.36% at March 31, 2013)	13,125	5,625
12 Year Loan, maturing June 2020		
Tranche A (effective interest rate of 5.18%)	54,375	61,875
Tranche B (floating interest rate of 1.35% at March 31, 2013)	13,125	5,625
2.95% Loan, maturing January 2021 (effective interest rate of 3.08%)	72,000	81,000
	1,295,125	1,304,125
Less: Deferred financing costs and unamortized bond discounts	(8,913)	(9,893)
Current portion	(149,000)	(9,000)
Total	1,137,212	1,285,232

In May 2004, the Group entered into a master trust indenture which established common security and a set of common covenants for the benefit of all lenders under the Group's financing plan. The financing plan encompasses an ongoing program capable of accommodating a variety of corporate debt instruments and borrowings, ranking *pari passu*.

The Group has issued five series of obligation bonds under the Master Trust Indenture ("MTI") and entered into a credit facility agreement. In addition, the Group has entered into loan agreements which provided $288 million to partially finance the Group's purchase of two Super 'C' class vessels and one northern vessel. These funds were released to coincide with the conditional acceptance of the vessels in February 2008, May 2008 and January 2009.

(a) Bonds:

Bonds are issued under supplemental indentures either as obligation bonds or as pledged bonds. The bonds are secured by a registered first mortgage and charge over vessels, an unregistered first mortgage and charge over ferry terminal leases, and by a general security agreement on property and contracts. The bonds are redeemable in whole or in part at the option of the Group. The following table shows the semi-annual interest payment dates for the obligation bonds each year through to maturity.

Bonds	Interest payment dates	
Series 04-1	May 27	November 27
Series 04-4	April 13	October 13
Series 07-1	March 20	September 20
Series 08-1	January 11	July 11
Series 08-2	December 19	June 19

(b) 12 Year Loans:

Proceeds of $90.0 million were received in each of February 2008 and May 2008 for the partial financing of the purchase of the *Coastal Inspiration* and the *Coastal Celebration* to coincide with conditional acceptance of these vessels from the shipyard. Quarterly payments are due in March, June, September and December each year of the term of the loans.

These loan agreements deferred the principal payments for the first three years to a second tranche (Tranche B) on which interest only is paid in periods ranging from one to six months at the option of the Group, with the principal balance due when the loan matures. The interest rates on Tranche B are reset at floating rates of CAD LIBOR plus 30 bps (effective June 2013, CDOR plus 30 bps), which will vary depending on the interest payment period. During the quarter ended September 30, 2011, the Group entered into amendments to the two loan agreements. These amendments allowed for the continuance of Tranche B for three years provided that the outstanding balance of Tranche B was fully prepaid. The Group fully prepaid the outstanding Tranche B balances of both loans ($22.5 million each); consequently, the Tranche A principal payments will be financed by draws under Tranche B until June 2014.

(c) 2.95% Loan:

Proceeds of $108.0 million were received in January 2009 and applied toward the purchase of the *Northern Expedition* to coincide with conditional acceptance from the shipyard. Equal semi-annual principal payments plus interest are due in January and July each year of the 12 year term of the loan.

(d) Credit facility:

The Group has a credit facility with a syndicate of Canadian banks, secured by pledged bonds. This revolving facility, in the amount of $155.0 million, was amended on April 20, 2012 to extend the maturity date from May 2013 to April 2017. It was further amended on March 15, 2013 to extend the maturity date from April 2017 to April 2018. There were no draws on this credit facility as at March 31, 2013 (March 31, 2012: $17.7 million).

Interest expensed during the year ended March 31, 2013, was less than $0.1 million (2012: less than $0.1 million). Letters of credit outstanding against this facility at March 31, 2013 totalled $0.1 million (March 31, 2012: $0.1 million).

(e) Debt service reserves:

The Group is required to maintain debt service reserves for the Series 04-1, 04-4, 07-1, 08-1 and 08-2 bonds equal to not less than six months forecasted debt service, to be increased under certain conditions. Further debt service reserves are required to be maintained for the 12 year loans and the 2.95% loan equal to not less than six months forecasted debt service, to be increased under certain conditions.

As at March 31, 2013, debt service reserves of $35.6 million were held in short-term investments and have been classified as restricted short-term investments on the balance sheet (March 31, 2012: $35.7 million).

5. FINANCIAL INSTRUMENTS:

The carrying and fair values of the Group's financial instruments are as follows:

	2013		2012	
As at March 31	Carrying Value	Approx Fair Value	Carrying Value	Approx Fair Value
Available for sale[1]				
Cash	19,043	19,043	4,034	4,034
Financial assets/liabilities at fair value through net earnings or loss[2]				
Cash equivalents	93	93	1,457	1,457
Derivative liabilities	12	12	12	12
Held-to-maturity[3]				
Cash equivalents	17,505	17,505	2,209	2,209
Restricted short-term investments	35,575	35,575	35,705	35,705
Other short-term investments	43,403	43,403	26,880	26,880
Loans and receivables[3]				
Trade and other receivables	18,118	18,118	42,341	42,341
Long-term loan receivable[4]	24,515	24,515	24,515	24,515
Other financial liabilities[3]				
Accounts payable and accrued liabilities	51,803	51,803	50,708	50,708
Short-term debt	–	–	17,737	17,737
Interest payable on long-term debt	18,063	18,063	18,249	18,249
Provisions	50,839	50,839	47,022	47,022
Long-term debt, including current portion[5,6]	1,286,212	1,486,749	1,294,232	1,491,008

1 Measured at fair value with revaluation gains and losses included in other comprehensive income until the asset is removed from the balance sheet. Due to the nature of this financial instrument, carrying value approximates fair value.

2 Measured at fair value with all gains and losses included in net earnings in the period in which they arise. Fair values for the derivative liabilities have been estimated using period-end market rates. These fair values approximate the amount that the Group would pay to settle the contract at March 31.

3 Measured at amortized cost. Due to the nature of these financial instruments and/or short-term maturity of these financial instruments, carrying value approximates fair value except as noted.

4 Measured at amortized cost. Carrying value approximates fair value as the rate of return is variable and is expected to return a market rate of interest.

5 Carrying value is measured at amortized cost using the effective interest rate method.

6 Fair value is calculated by discounting the future cash flows of each debt issue at the estimated yield to maturity for the same or similar issues at March 31, or by using available quoted market prices.

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates cannot be determined with precision as they are subjective in nature and involve uncertainties and matters of judgment. Where market prices are not available, fair values are estimated using discounted cash flow analysis based on the Group's current borrowing rate for similar borrowing arrangements.

No amounts have been reclassified into or out of fair value classifications in the year. Financial assets have been pledged as security for liabilities under the MTI (note 4). The Group does not hold any multiple embedded derivative financial assets or liabilities. No loans or receivables or financial liabilities have been categorized as fair value through net earnings or loss.

As at March 31, 2013, all available for sale and held-for-trading financial instruments are classified as level 1 in the fair value hierarchy with quoted prices in active markets.

During the year ended March 31, 2013, no profits resulting from the use of valuation techniques used to measure level 2 or 3 instruments in the fair value hierarchy (i.e. those with no active market price) have been recognized.

The Group may use derivative instruments to hedge its exposure to fluctuations in fuel prices, interest rates and foreign currency exchange rates. The fair value of commodity derivatives reflects only the value of the commodity derivatives and not the offsetting change in value of the underlying future purchase of fuel. These fair values reflect the estimated amounts that the Group would receive or pay should the derivative contracts be terminated at the stated dates.

6. FINANCIAL RISK MANAGEMENT:

Exposure to credit risk, liquidity risk, and market risk arises in the normal course of the Group's business. The Group manages market risk arising from the volatility in foreign currency, interest rate, and fuel price exposures in part through the use of derivative financial instruments including forward contracts, swaps and options. The Group does not utilize derivative financial instruments for trading or speculative purposes. At the inception of each hedge the Group determines whether it will or will not apply hedge accounting. No hedges have been designated as at March 31, 2013 and 2012.

(a) Credit risk:

Credit risk is the risk that a third party to a financial instrument might fail to meet its obligations under the terms of the financial instrument. For cash and cash equivalents, short-term investments, derivative assets and trade and other receivables the Group's credit risk is limited to the carrying value on the statements of financial position. Management does not believe that the Group is subject to any significant concentration of credit risk.

The Group limits its exposure to credit risk on cash and cash equivalents and investments by investing in liquid securities with high credit quality counter parties, placing limits on tenor of investment instruments and instituting maximum investment values per counter party.

Accounts receivable by source are as follows:

	2013		2012	
As at March 31	$	%	$	%
Trade customers and miscellaneous	8,305	45.8%	7,692	18.2%
Federal and Provincial governments	9,813	54.2%	34,649	81.8%
Total	18,118	100.0%	42,341	100.0%

Accounts receivable from trade customers are primarily due from commercial customers and transportation operators. Credit risk is reduced by a large and diversified customer base and is managed through the review of third party credit reports on customers both before extending credit and during the business relationship. The Group manages its exposure to credit risk associated with all customers through the monitoring of aging of receivables, by collecting deposits from and adjusting credit terms for higher risk customers and customers who are not on a pre-authorized payment plan. Amounts due from tickets sold to passengers through the use of major credit cards are settled shortly after sale and are classified as cash and cash equivalents on the balance sheet.

Accounts receivable from trade customers are generally due in 30 days. As at March 31, 2013, 96% of trade receivables are current. As at March 31, 2013, the provision for credit losses was $0.1 million (2012: $0.1 million) and reflects management's estimate of uncollectible receivables from trade customers based on past experience and analysis of customer accounts.

Amounts due from the Government of Canada and the Province are considered low credit risk.

The Group is exposed to credit risk in the event that a counter party in a derivative contract defaults on its obligation, including fuel commodity swaps and foreign exchange forward contracts. The Group manages the credit exposure related to financial instruments by dealing with high credit quality institutions, in accordance with established investment parameters, and by an ongoing review of its exposure to counter parties. Counter party credit rating and exposures are monitored by management on an ongoing basis, and are subject to approved credit limits. The counter parties with which the Group has significant derivative transactions must be rated single A or higher. The Group does not expect any counter parties to default on their obligations.

(b) Liquidity risk:

Liquidity risk is the risk that an entity will not be able to meet its obligations associated with its financial liabilities. The Group's financial position could be adversely affected if it fails to arrange sufficient and cost effective financing to fund, among other things, capital expenditures and the repayment of maturing debt. The ability to arrange sufficient and cost effective financing is subject to numerous factors, including the results of operations and financial position of the Group, conditions in the capital and bank credit markets, ratings assigned by rating agencies and general economic conditions.

The Group manages liquidity risk through daily monitoring of cash balances, the use of long-term forecasting models and the maintenance of debt service reserves (note 4). The Group targets a strong investment grade credit rating to maintain capital market access at reasonable interest rates. As at March 31, 2013 and March 31, 2012, the Group's credit ratings were as follows:

	DBRS	Standard & Poor's
British Columbia Ferry Services Inc.:		
Senior secured long-term debt	A	A+

The following is an analysis of the contractual maturities of the Group's financial liabilities as at March 31, 2013:

	< 1 year	2-3 years	4-5 years	> 5 years	Total
Financial liabilities					
Accounts payable and accrued liabilities	51,803	–	–	–	51,803
Interest payable on long-term debt	18,063	–	–	–	18,063
Provisions	50,839	–	–	–	50,839
Obligations under finance lease, including current portion	1,072	2,431	3,096	40,414	47,013
Long-term debt, including current portion (excluding deferred costs)[1]	149,000	294,250	48,000	803,875	1,295,125
Total financial liabilities – principal only	270,777	296,681	51,096	844,289	1,462,843
Interest payable – long-term debt[2]	66,963	91,912	85,650	720,352	964,877
Interest payable – obligations under finance lease	2,026	3,907	3,663	10,853	20,449
Total financial liabilities, including interest payable	339,766	392,500	140,409	1,575,494	2,448,169

1 Carrying value at March 31, 2013, excludes unamortized deferred financing costs of $8.9 million. The majority of the Group's long-term debt relates to acquisition of property, plant & equipment and intangible assets.

2 Interest payable on long-term debt excludes the variable rate interest payable on Tranche B of the 12 Year loans (note 4(b)).

(c) **Market risk:**

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate due to changes in market interest rates, foreign currency prices or fuel prices.

Interest rate risk:

The Group is exposed to interest rate risk associated with short-term borrowings and floating rate debt. As at March 31, 2013, the Group's cash equivalents and short-term investments include fixed rate instruments with maturities of 185 days or less. Accordingly, the Group has exposure to interest rate movement that occurs beyond the term of the maturity of the fixed rate investments. The Group's credit facility and the second tranche of each of the two 12 year loans are at variable rates and are subject to interest rate risk. To manage this risk, the Group maintains between 70% and 100% of its debt portfolio in fixed rate debt, in aggregate. Additionally, the Group may enter into interest rate agreements to manage its exposure on debt instruments. As at March 31, 2013, the Group has no interest rate agreements in place to offset interest rate risk and had approximately two per cent of total debt in variable rate instruments. A 50 basis point change in interest rates would not have had a significant effect on earnings for the twelve months ended March 31, 2013. The Group has two bond series maturing over the next 14 months with a total face value of $390 million and coupons of 6.214% and 5.74%. A 1% change in the interest rates would result in a $3.9 million increase or decrease to the Group's earnings annually.

Foreign currency price risk:

The Group is exposed to risk from foreign currency prices on financial instruments, such as accounts payable and future purchase commitments denominated in currencies other than the Canadian dollar. To manage exposure on future purchase commitments, the Group reviews foreign currency denominated commitments and hedges through derivative instruments as necessary. As at March 31, 2013, the Group has foreign currency forward contracts of $1.0 million (2012: $1.5 million). A 10 per cent change in foreign exchange rates would not have had a significant effect on earnings for the twelve months ended March 31, 2013.

Fuel price risk:

The Group is exposed to risks associated with changes in the market price of marine diesel fuel. The Group may manage its exposure to fuel price volatility by entering into hedging instruments with certain financial intermediaries in order to reduce price volatility and add a fixed component to the inherent floating nature of fuel prices. Fuel price hedging instruments are used solely for the purpose of reducing fuel price risk, not for generating trading profits. Gains and losses resulting from fuel forward contracts are recognized as a component of fuel costs. Pursuant to the Group's Financial Risk Management Policy, the term of the contracts is not to extend beyond three years. This policy limits hedging, to a maximum of 95% of anticipated monthly fuel consumption for the immediately following 12 month period; 90% of anticipated monthly fuel consumption for the 12 month period thereafter and to 85% of anticipated monthly fuel consumption for the remaining 12 month period.

The Group is also allowed by regulatory order to use deferred fuel cost accounts to mitigate the impact of changes in fuel price on its earnings.

Prior to June 25, 2012, the regulatory deferred fuel cost accounts operated as follows:

Any differences between the per litre cost of fuel purchased and consumed (including hedge gains or losses) and the per litre cost of fuel included in the determination of price caps were:

i) for those routes comprising the Northern Route Group;

   a. one-half of the first 5 cents per litre of difference was recorded in expense for the period with the remaining one-half of the first 5 cents per litre of difference recorded in deferral accounts for recovery or settlement through future tariffs to customers (note 21(b)), and

   b. any difference beyond 5 cents per litre was recorded in accounts receivable or payable for subsequent recovery from or payment to the Province, and

ii) for all other routes;

   a. one-half of the first 5 cents per litre of difference was recorded in expense for the period with all remaining differences per litre recorded in deferral accounts for recovery or settlement through future tariffs to customers (note 21(b)).

Commencing June 25, 2012, the regulatory deferred fuel cost accounts operate as follows:

Any differences between the per litre cost of fuel purchased and consumed (including hedge gains or losses) and the per litre cost of fuel included in the determination of price caps are:

i) for those routes comprising the Northern Route Group;

   a. the first 5 cents per litre of difference is recorded in deferral accounts for recovery or settlement through future tariffs to customers (note 21(b)).

   b. any difference beyond 5 cents per litre is recorded in accounts receivable or payable for subsequent recovery from or payment to the Province, and

ii) for all other routes;

   a. recorded in deferral accounts for recovery or settlement through future tariffs to customers (note 21(b)).

If the Group was permitted under IFRS to recognize the effects of rate regulation, there would be no effect on comprehensive income from changes in fuel prices.

During the year ended March 31, 2013, the amounts receivable from the Province in relation to fuel cost differences totalled $1.0 million (2012: $1.8 million receivable from the Province).

7. INVENTORIES:

As at March 31	2013	2012
Food and retail inventories	3,436	3,272
Fuel inventories	4,140	4,551
Consumable parts and supplies	15,681	14,193
Total	23,257	22,016

8. OBLIGATIONS UNDER FINANCE LEASE:

During the year ended March 31, 2011, agreements which constitute a finance lease for space in a new downtown Victoria, BC head office building took effect following the completion of construction of the new building. The initial term of the new building lease is for fifteen years, with four renewal options of five years each. The lease agreement includes payment of building operating costs and property taxes based on the Group's proportion of total rentable area.

Loan and purchase option:
During the year ended March 31, 2012, the Group's wholly-owned subsidiary, Pacific Marine Leasing Inc., advanced $0.3 million to the developer of the new head office property to finalize the loan amount at $24.5 million. The term of the loan is fifteen years, secured by a second mortgage on the property. The loan agreement provides for interest equal to one-half of the net cash flow from the property, subject to minimum and maximum percentage rates of interest. Over the term of the loan, interest is expected to approximate the market rate when the loan was made. Incidental to the loan, the Group was granted an option to purchase up to fifty percent of the owner's equity interest in the new building at a price of $24.5 million. The purchase option expires at the end of the loan term.

Future minimum lease payments and obligations under the head office and other capital leases are as follows:

	Minimum lease payments	Executory costs	Imputed interest (4.44%)	Obligation
Less than one year	4,788	1,690	2,026	1,072
Between one and five years	20,200	7,103	7,570	5,527
Later than five years	42,235	15,483	10,853	15,899
Purchase option	24,515	–	–	24,515
Total	91,738	24,276	20,449	47,013
Current portion				(1,072)
Non-current portion				45,941

9. LONG-TERM LAND LEASE:

On April 1, 2003, the Group's land and structures comprising its terminals were transferred by the Group to the BC Transportation Financing Authority ("BCTFA"), a British Columbia Crown Corporation and related party at the time of the transaction. In exchange, the Group received recognition of a prepayment for leases of the transferred terminal structures and land. The structures, having lives of less than the lease term, are considered a capital lease and as such have been capitalized and included with capital assets and are amortized in accordance with the Group's amortization policy.

The land, having an indefinite useful life, is considered an operating lease. The prepayment of the land lease has been deferred and will be amortized on a straight-line basis over eighty years, being the initial sixty year lease period plus an additional twenty year bargain renewal option.

The transaction was initially recorded at the carrying values of the transferred terminal structures and land.

Since April 1, 2003, the Group has entered into various agreements with BCTFA to add lands to the existing terminal leases. During the years ended March 31, 2013 and March 31, 2012, no new land costs were added to the terminal leases.

10. PROPERTY, PLANT AND EQUIPMENT:

(a) Continuity of property, plant and equipment:

	Vessels	Berths, building & equipment under finance lease	Berths, building & equipment	Land under finance lease	Land	Construction in progress	Total
Cost:							
Balance at April 1, 2011	1,077,392	426,338	42,672	5,177	13,101	28,514	1,593,194
Additions	–	268	–	–	–	128,807	129,075
Revaluation	–	–	–	235	1,942	–	2,177
Disposals	(1,998)	(189)	(85)	–	–	(415)	(2,687)
Reclassification	(43)	(99)	99	–	–	–	(43)
Transfers from construction in progress	68,289	56,965	9,826	–	471	(135,551)	–
Balance at March 31, 2012	**1,143,640**	**483,283**	**52,512**	**5,412**	**15,514**	**21,355**	**1,721,716**
Additions	–	–	–	–	–	84,030	84,030
Revaluation	–	–	–	–	936	–	936
Disposals	(11,043)	(288)	(192)	–	–	(79)	(11,602)
Reclassification	(297)	(73)	73	–	–	–	(297)
Transfers from construction in progress	41,752	25,989	6,897	–	–	(74,638)	–
Balance at March 31, 2013	**1,174,052**	**508,911**	**59,290**	**5,412**	**16,450**	**30,668**	**1,794,783**
Accumulated depreciation:							
Balance at April 1, 2011	–	–	–	–	–	–	–
Depreciation for the year	96,751	22,568	7,947	–	–	–	127,266
Disposals	(1,801)	(189)	(67)	–	–	–	(2,057)
Reclassification	–	(99)	99	–	–	–	–
Balance at March 31, 2012	**94,950**	**22,280**	**7,979**	–	–	–	**125,209**
Depreciation for the year	96,224	24,443	8,257	–	–	–	128,924
Disposals	(10,945)	(288)	(179)	–	–	–	(11,412)
Reclassification	–	(73)	73	–	–	–	–
Balance at March 31, 2013	**180,229**	**46,362**	**16,130**	–	–	–	**242,721**
Net carrying value:							
As at April 1, 2011	**1,077,392**	**426,338**	**42,672**	**5,177**	**13,101**	**28,514**	**1,593,194**
As at March 31, 2012	**1,048,690**	**461,003**	**44,533**	**5,412**	**15,514**	**21,355**	**1,596,507**
As at March 31, 2013	**993,823**	**462,549**	**43,160**	**5,412**	**16,450**	**30,668**	**1,552,062**

(b) Other disclosures – property, plant and equipment:

During the year ended March 31, 2013 capitalized financing costs during construction amounted to $0.7 million (March 31, 2012: $1.5 million) with an average capitalization rate of 5.64% (March 31, 2012: 5.62%). The contractual commitments at March 31, 2013 for assets to be constructed totalled $23.1 million (March 31, 2012: $13.1 million).

The Government of Canada, through the Infrastructure Stimulus Program, agreed to provide funding to help offset the costs of sewage and waste water treatment and other major projects at certain of the Group's terminals. The Group received a total of $8.7 million under this program. During the year ended March 31, 2012 $2.6 million of this amount was recorded as a reduction of property, plant and equipment. The remaining $6.1 million was recorded in previous years.

During the year ended March 31, 2013, the Group received $0.7 million (March 31, 2012: $0.7 million) of rental income earned from buildings held for leasing purposes. These buildings have a cost and accumulated depreciation of $11.9 million and $0.9 million respectively, as at March 31, 2013.

11. INTANGIBLE ASSETS:

(a) Continuity of intangible assets:

	Acquired software, licenses & rights	Internally developed software & website	Assets under development	Total
Cost:				
Balance at April 1, 2011	16,708	8,269	9,952	34,929
Additions	–	–	13,112	13,112
Disposals	–	–	–	–
Transfers from assets under development	6,077	2,510	(8,587)	–
Balance at March 31, 2012	**22,785**	**10,779**	**14,477**	**48,041**
Additions	–	–	12,935	12,935
Disposals	(357)	–	–	(357)
Transfers from assets under development	1,941	32	(1,973)	–
Balance at March 31, 2013	**24,369**	**10,811**	**25,439**	**60,619**
Accumulated amortization and impairment:				
Balance at April 1, 2011	–	–	–	–
Amortization for the year	4,050	2,233	–	6,283
Disposals	–	–	–	–
Balance at March 31, 2012	**4,050**	**2,233**	**–**	**6,283**
Amortization for the year	4,509	2,242	–	6,751
Disposals	(357)	–	–	(357)
Balance at March 31, 2013	**8,202**	**4,475**	**–**	**12,677**
Net carrying value:				
As at April 1, 2011	**16,708**	**8,269**	**9,952**	**34,929**
As at March 31, 2012	**18,735**	**8,546**	**14,477**	**41,758**
As at March 31, 2013	**16,167**	**6,336**	**25,439**	**47,942**

(b) Other disclosures – intangible assets:

There was no impairment of intangible assets during the year ended March 31, 2013 or the year ended March 31, 2012.

Capitalized financing costs during construction for intangible assets for the year ended March 31, 2013 totalled $1.1 million (March 31, 2012: $0.5 million).

During the year ended March 31, 2013, intangible assets totalling $12.4 million (March 31, 2012: $12.7 million) were acquired and $0.5 million (March 31, 2012: $0.5 million) were internally developed.

12. ACCRUED EMPLOYEE FUTURE BENEFITS:

(a) Description of benefit plans:

	Funding status	Administrator	Plan type	Basis of accounting
Public Service Pension	funded	Third Party	Multi-employer defined benefit	Defined contribution
Retirement bonus	unfunded	Group	Defined benefit	Defined benefit
Death benefit	unfunded	Group	Defined benefit	Defined benefit
Long-term disability	funded	Third Party	Multi-employer defined benefit	Defined contribution
Supplemental executive retirement plan	unfunded	Group	Defined benefit	Defined benefit
Sick Bank obligation	unfunded	Group	Defined benefit	Defined benefit
WCB obligation	unfunded	Third Party	Defined benefit	Defined benefit

The Group and its employees contribute to the Public Service Pension Plan (the "Plan"). The Pension Corporation of the Province of British Columbia administers the Plan, including the payment of retirement and post-employment benefits on behalf of employers. The Plan is a multi-employer defined benefit pension plan. Under joint trusteeship, which became effective January 1, 2001, the risk and reward associated with the Plan's unfunded liability or surplus is shared between the employers and the plan members and will be reflected in their future contributions. Sufficient information is not available for this plan to be accounted for as a defined benefit plan.

In addition, eligible employees are entitled to other retirement and future benefits as provided for under the collective agreement and terms of employment. A retirement bonus and a death benefit, both unfunded defined benefit plans and both administered by the Group, are based on years of service and final average salary. A funded long-term disability multi-employer plan provides disability income benefits after employment, but before retirement. Sufficient information is not available for this plan to be accounted for as a defined benefit plan.

The Group administers an unfunded supplemental executive retirement plan which encourages continued retention and provides additional pension compensation.

The Group also administers an unfunded accumulated sick leave bank ("Sick Bank obligation") consisting of unused sick time credits earned prior to the discontinuation of the sick leave accumulation benefit in 1979. Accumulated sick leave may be drawn down at 100% or paid out at 50%. Benefits are paid out at current salary rates. No new credits are accumulated to this bank.

The Group's employees may also receive compensation benefits arising from claims prior to March 31, 2003, administered by the Workers' Compensation Board ("WCB obligation"). Prior to March 31, 2003, the Group participated in the Workers' Compensation Board deposit class coverage system. Subsequent to March 31, 2003, the Group has been covered under the Workers' Compensation Board rate system. The change to the rate system resulted in a residual liability from the deposit class system that has been valued by actuarial assumptions as appropriate for a closed plan. Currently this obligation is unfunded.

(b) Total cash payments:

Total cash payments for employee future benefits for the year ended March 31, 2013, consisting of cash contributed by the Group to its multi-employer defined benefit plans, cash payments directly to beneficiaries for its unfunded other benefit plans, and cash contributed to a third party administrator of an unfunded plan, was $28.9 million (2012: $26.5 million).

(c) Defined benefit plans:

All of the Group's defined benefit plans, except its multi-employer plans, are currently unfunded. The most recent actuarial valuation of the retirement bonus and death benefit plans is as at March 31, 2011. A plan amendment at December 31, 2007 restricts exempt employees from joining the retirement bonus and death benefit plans. As part of an implementation plan to assist with the transition of certain shipboard management to excluded positions, a further plan amendment was made during the year ended March 31, 2011. This amendment allows bargaining unit employees transferring to excluded positions to continue to be eligible for the retirement bonus, provided the transfer happens on or before December 31, 2013. The most recent actuarial valuations of the WCB obligation, the supplemental executive retirement plan and the Sick Bank obligation are as at March 31, 2011, March 31, 2013 and March 31, 2001, respectively.

	2013	2012
Other benefit plans		
Accrued benefit obligations		
Balance, beginning of year	19,565	18,378
Current service cost	648	1,296
Interest cost	801	804
Benefits paid	(2,200)	(1,871)
Actuarial (gains) losses	(6)	958
Balance, end of year	18,808	19,565

	2013	2012
Other benefit plans		
Reconciliation of funded status of the benefit plans to the amounts recorded in the financial statements		
Fair value of plan assets	–	–
Accrued benefit obligation	18,808	19,565
Funded status of plans – deficit	(18,808)	(19,565)
Accrued benefit liability	(18,808)	(19,565)
Current portion of accrued employee future benefits	2,204	2,204
Accrued employee future benefits	(16,604)	(17,361)

	2013	2012
Other benefit plans		
Elements of defined benefit costs recognized in the year		
Current service cost	648	1,296
Interest cost	801	804
Actuarial (gains) losses	(6)	958
Defined benefit costs recognized	1,443	3,058

Significant assumptions

The significant assumptions used are as follows (weighted average):

	2013	2012
Accrued benefit obligation as of March 31:		
Discount rate	5.0%	5.0%
Rate of compensation increase	1.9%	1.8%
Annual employee retention rate	96.0%	95.7%
Employees with eligible dependents at pre-retirement death	43.0%	43.0%
Benefit cost for years ended March 31:		
Discount rate	5.0%	5.0%
Rate of compensation increase	1.9%	1.8%
Annual employee retention rate	96.0%	95.7%
Employees with eligible dependents at pre-retirement death	43.0%	43.0%
Average remaining service period of active employees (years)	7.0	7.0

(d) Multi-employer plans:

The total cost recognized for the Group's multi-employer plans is as follows:

	2013	2012
Public Service Pension Plan contributions (i)	21,269	19,656
Long-term disability plan contributions	5,477	4,952
Long-term disability plan amortization of surplus (ii)	64	64
Total	26,810	24,672

i) The March 31, 2011 actuarial valuation report for the Public Service Pension Plan was received by the Public Service Pension Board of Trustees on December 6, 2011. This report indicated that the pension fund has a deficit of $275 million. Under the terms of the plan's joint trust agreement, plan members and employers share in any increase or decrease in contribution rates. Effective April 1, 2012 the plan trustees increased the member and employer contribution rates to the basic account from 7.78% to 8.18% of pensionable earnings. This increase is primarily due to changes in the investment return and demographic assumptions. The contribution rates to the inflation adjustment account decreased for members from 1.50% to 1.25% and increased for employers from 2.5% to 2.75%, effective April 1, 2012. The next valuation, expected to be received during the fiscal year ended March 31, 2015, will be as at March 31, 2014.

ii) Contribution rates for the long-term disability plan are actuarially determined every three years as a percentage of covered payroll. The most recent valuation, as at March 31, 2011, determined an overall fund surplus. The newly established funding policy calls for amortization of individual participating employer deficits and surpluses over 5 years and a 110% funding target for each participant in 5 years. As a result the employer contribution rate was increased from 3.09% to 3.5% of covered payroll effective April 1, 2012. The next scheduled valuation, expected to be received during the fiscal year ended March 31, 2015, will be as at March 31, 2014.

13. PROVISIONS:

	Wages payable	Claims payable	Total
Balance at April 1, 2011	45,411	1,377	46,788
Provisions arising during the year	52,772	431	53,203
Provisions settled during the year	(52,438)	(531)	(52,969)
Balance at March 31, 2012	45,745	1,277	47,022
Provisions arising during the year	55,296	712	56,008
Provisions settled during the year	(51,895)	(296)	(52,191)
Balance at March 31, 2013	49,146	1,693	50,839

Wages payable consists of contractual liabilities to employees for deferred or accrued compensation. Liabilities for deferred compensation amounts are generally settled either through payment or provision of paid time off.

Claims payable represents reserves for settlement amounts payable to third parties for injuries or damage to persons or property.

14. CAPITAL MANAGEMENT:

The Group's principal business of ferry transportation requires ongoing access to capital in order to fund operations, satisfy outstanding long-term debt obligations and fulfill future capital asset acquisition obligations. In order to ensure capital market access is maintained, the Group targets maintaining strong investment grade credit ratings (note 6(b)).

The capital structure of the Group is presented in the following table:

	2013		2012	
As at March 31,	$	%	$	%
Aggregate borrowings[1]	1,497,138	81.73	1,507,112	82.25
Total equity before reserves	334,665	18.27	325,195	17.75
Total	1,831,803	100.00	1,832,307	100.00

1 Includes long-term debt, including current portion, credit facility (drawn and undrawn) and short-term borrowings.

The Group has covenants restricting the issuance of additional debt, distributions to shareholders, and guarantees and investments. Incurrence of additional debt and distributions are restricted when aggregate borrowings exceed 85% of the Group's total capital while certain guarantees and certain investments may be restricted when aggregate borrowings exceed 75%.

Debt service coverage (earnings before interest, taxes, depreciation, amortization, and rent) must be at least 1.25 times the debt service cost and the Group is required to maintain debt service reserves (notes 4 and 6). Incurrence of additional debt is restricted if the debt service coverage ratio is less than 1.5 times the debt service cost and distributions are restricted if the debt service coverage ratio is less than 1.3 times. In addition to these restrictions and requirements, there are other covenants contained in the MTI (May 2004) available at www.SEDAR.com. The Group was in compliance with all of its covenants throughout the years ended March 31, 2013 and 2012.

15. SHARE CAPITAL:

(a) Authorized:

1,000,000 Class A voting common shares, without par value

1 Class B voting common share, without par value

80,000 Class C non-voting, 8% cumulative preferred shares, with a par value of $1,000 per share, convertible to Class A shares upon the sale of the outstanding Class B share by the initial shareholder. Special rights attached to the Class C shares restrict the Group's ability to issue shares and to declare dividends.

(b) Issued and outstanding:

	2013		2012	
As at March 31	Number of shares	Amount $	Number of shares	Amount $
Class B, common	1	1	1	1
Class C, preferred	75,477	75,477	75,477	75,477
		75,478		75,478

(c) Dividends:

Dividends on the Class C cumulative preferred shares, if declared, are payable annually on March 31 of each year. All dividend entitlements to date have been paid.

16. CONTRIBUTED SURPLUS:

On March 30, 2012, the Province confirmed that it had approved a contribution to the equity of the Group in the amount of $25 million payable as at March 31, 2012. This amount has been included in accounts receivable at March 31, 2012 and was received on April 20, 2012.

17. LAND REVALUATION RESERVE:

As at March 31	2013	2012
Balance – beginning of year	2,177	–
Fair value increases	1,056	2,177
Balance – end of year	3,233	2,177

The land revaluation reserve represents the cumulative surplus resulting from changes in fair value of land assets.

During the year ended March 31, 2013 net land asset values increased by $0.9 million (March 31, 2012: $2.2 million). Land revaluation reserves increased by $1.1 million (March 31, 2012: $2.2 million) reflecting an increase in land value while $0.2 million (March 31, 2012: $nil) was expensed in net earnings reflecting a reduction to the fair value of a parcel of land with no reserve.

18. FERRY SERVICE FEES:

The Group entered into an agreement with the Province commencing April 1, 2003 to provide ferry services that would not be commercially viable under the current regulated tariff structure. In exchange for fees, the Group provides agreed ferry service levels on specified routes and administers certain social policy initiatives on behalf of the Province. The agreement is for a period of sixty years, the details of which are renegotiated after a first term of five years and each four year term thereafter. The agreement was amended on June 30, 2007, March 31, 2008 and April 1, 2012 to, among other things, establish the ferry service levels and the fees for the provision of such service for the second performance term ending March 31, 2012 and for the third performance term ending March 31, 2016.

19. FEDERAL-PROVINCIAL SUBSIDY AGREEMENT:

The Group receives revenue provided to the Province from the Government of Canada pursuant to a contract between the federal and provincial governments for the provision of ferry, coastal freight and passenger services in the waters of British Columbia. The annual payment increases with the Vancouver Consumer Price Index.

20. REGULATED OTHER INCOME:

In May 2012, the Province of British Columbia enacted changes to the Act (Bill 20) that among other things, includes reservation fees as a regulated tariff for the purposes of determining adherence to price caps established by the Commissioner effective April 1, 2012. These fees were not regulated by the Commissioner prior to April 1, 2012.

21. ECONOMIC EFFECT OF RATE REGULATION:

The Group is regulated by the Commissioner to ensure, among other things, that tariffs are fair and reasonable. Under the terms of the Act, the tariffs the Group charges its customers are subject to price caps. The Commissioner may, under certain circumstances, allow increases in price caps over the set levels.

IFRS does not have a standard for rate-regulated activities and therefore does not allow the recognition of regulatory assets and regulatory liabilities that result from the regulated price cap setting process. Regulatory assets generally represent incurred costs that have been deferred for purposes of rate regulation because they are probable of future recovery in tariffs. Regulatory liabilities represent obligations to customers which will be settled through future tariff reductions. Management continually assesses whether the Group's regulatory assets are probable of future recovery by considering such factors as applicable regulatory changes. Management believes the regulatory assets at March 31, 2013 detailed below are probable of future recovery and that the obligations represented by the regulatory liabilities will be settled through future tariff reductions.

If the Group was permitted under IFRS to recognize the effects of rate regulation, the following regulatory assets and regulatory liabilities would be shown on the consolidated statement of financial position:

As at March 31	2013	2012
Regulatory accounts		
Deferred first performance term costs (a):		
Balance – beginning of year	–	4,775
Amortization for the year	–	(4,775)
Balance – end of year	–	–
Continuing regulatory accounts:		
Deferred fuel costs (b):		
Balance – beginning of year	1,256	(1,790)
Fuel costs deferred	11,266	19,486
Surcharges collected	(11,469)	(13,098)
Fuel price risk recoveries from the Province	(1,023)	(1,799)
Other payments from the Province	(1,449)	(1,503)
Interest receivable (payable)	4	(40)
Balance – end of year	(1,415)	1,256
Tariffs in excess of price cap (c)	–	(2,461)
Performance term submission costs (d)	245	327
Total of regulatory accounts	(1,170)	(878)
Total regulatory (liabilities)	(1,170)	(878)
Current regulatory assets (liabilities)	82	(2,379)
Total long term regulatory (liabilities) assets	(1,252)	1,501

(a) Deferred first performance term costs:

During the four year period ended March 31, 2012, the Group recovered in tariffs $19.1 million of costs incurred during the first performance term. These costs primarily consisted of the cost of fuel consumed that was acquired at prices greater than those recovered through tariffs during the first performance term.

(b) Deferred fuel costs:

As prescribed by regulatory order, the Group defers differences between actual fuel costs and approved fuel costs which were used to develop the regulated price caps. The difference between the approved fuel costs and the actual fuel costs (including fuel hedge gains and losses) is deferred for settlement in future tariffs. Also prescribed by regulatory order, the Group collects fuel surcharges or provides fuel rebates from time to time which are applied against deferred fuel cost account balances and has included interest in the amount to be recovered from or returned to customers.

The Commissioner considered $18.5 million of unrecovered deferred fuel costs in the determination of the price caps set for the second performance term beginning April 1, 2008, and recovery occurred over this four year period. Accordingly, this $18.5 million was amortized to expense on a straight-line basis over the term. The difference between the balances in the deferred fuel cost accounts at March 31, 2008 and this $18.5 million, a $6.6 million credit, formed the opening balances of the fuel cost deferral accounts for the second performance term. The balance of $1.3 million in these accounts at March 31, 2012 formed the opening balance of the fuel cost deferral accounts and will be recovered during the third performance term, which commenced April 1, 2012.

During the year ended March 31, 2013, the Province agreed to pay $1.5 million, to be applied against the balance of deferred fuel costs (2012: $1.5 million).

(c) Tariffs in excess of price cap:

The Act contains provisions which ensure that if tariffs charged by the Group exceed established price caps, the excess amounts collected will be returned to customers through future tariffs. Tariffs charged to customers on all route groups were below established price caps at March 31, 2013. At March 31, 2012, tariffs charged to customers on the Major Route Group exceeded the price cap by $2.5 million.

(d) Performance term submission costs:

The Commissioner has authorized the Group to defer costs of representation associated with the second and third performance terms. The Commissioner has considered these costs in the determination of the price caps set for the four years beginning April 1, 2008, and for the four years beginning April 1, 2012. The Commissioner has not included an allowance for a return on investment for the second or third performance term submission costs. The recovery periods are the four year period of the second performance term, commencing April 1, 2008 and the four year period of the third performance term, commencing April 1, 2012.

If the Group was permitted under IFRS to recognize the effect of rate regulation and to record regulatory assets and regulatory liabilities, total comprehensive income for the year ended March 31, 2013 would have been $0.3 million lower (2012: $3.0 million lower) as detailed below:

Years ended March 31	2013	2012
Effect of rate regulation on total comprehensive income		
First performance term accounts:		
Amortization of deferred performance term costs	–	(4,775)
Continuing regulatory accounts:		
Deferred fuel costs	(2,671)	3,046
Performance term submission costs	(82)	95
Tariffs in excess of price cap	2,461	(1,389)
Total decrease in total comprehensive income	(292)	(3,023)

22. NET FINANCE EXPENSES:

Years ended March 31	2013	2012
Finance expenses		
Long-term debt	70,605	71,875
Short-term debt	409	246
Finance leases	2,325	2,373
Amortization of deferred financing costs and bond discounts	981	968
Interest capitalized in the cost of qualifying assets	(1,856)	(2,049)
Interest rate support (a)	(388)	(1,543)
Total finance expenses	72,076	71,870
Finance income	(2,922)	(2,404)
Total	69,154	69,466

(a) Interest rate support:

During the years ended March 31, 2012 and 2011, the Government of Canada agreed to provide $1.6 million and $1.0 million respectively in the form of interest rate support to the Group for major refurbishment of one vessel in each year. During the year ended March 31, 2013 interest rate support recorded as a reduction of interest expense totalled $0.4 million (March 31, 2012: $1.5 million) and $nil as a reduction of capitalized interest (March 31, 2012: $0.2 million).

The Group has no requirement to repay these funds, other than as a result of an event of default under the agreement with the Government of Canada.

23. OPERATING EXPENSES:

During the year ended March 31, 2013, the Group recorded $309 million (March 31, 2012: $303 million) for wages and benefit expenses.

During the year ended March 31, 2013, the Group recorded $121 million (March 31, 2012: $120 million) for fuel expenses.

24. RELATED PARTY TRANSACTIONS:

(a) Management compensation:

The compensation of the Group's directors and key executive officers during the year is as follows:

Years ended March 31	2013	2012
Short-term benefits	1,731	2,120
Post-employment benefits	290	1,215
Other long-term benefits	–	1,376
Total	2,021	4,711

(b) B.C. Ferry Authority:

In accordance with the Act, the Group is responsible for paying any expenses that are incurred by the Authority, without charge. During the year ended March 31, 2013, the Group paid $165,265 (March 31, 2012: $181,363) of such expenses.

The Province owns the Group's 75,477 nonvoting preferred shares, but has no voting interest in either the Group or the Authority.

25. SUBSIDIARIES:

As at March 31, 2013 two of the Group's subsidiary holdings, BCF Global Services Inc. and Pacific Marine Ventures Inc., were dissolved by way of voluntary dissolution under the Business Corporations Act.

26. OTHER COMMITMENTS:

The Group has entered into operating leases for certain building spaces, land and equipment. Lease payments charged to expense during the year ended March 31, 2013 were $1.1 million (2012: $1.0 million).

Future minimum lease payments are as follows:

Less than one year	810
Between one and five years	416
More than five years	–
Total	1,226

27. CONTINGENT LIABILITIES:

The Group, in conducting its usual business activities, is involved in various legal proceedings and litigation, the outcome of which is indeterminable. It is the Group's policy to carry adequate insurance to minimize the financial risk associated with such matters. Management is of the opinion that the aggregate net liability, if any, of these proceedings and litigation would not be significant to the Group. Any additional future costs or recoveries which differ from the accrued amounts will be recognized in net earnings as determined.

28. TRANSITION TO IFRS:

These consolidated financial statements for the year ended March 31, 2013 are the Group's first annual consolidated financial statements prepared in accordance with IFRS and have been prepared as described in note 1, including the application of *First-Time Adoption of International Financial Reporting Standards* ("IFRS 1").

IFRS 1 requires an entity to adopt IFRS in its first annual financial statements prepared in accordance with IFRS by making an explicit and unreserved statement in those financial statements of compliance with IFRS. This statement is made at note 1 (b).

IFRS 1 also requires that comparative financial information be provided. As a result, the first date at which the Group has applied IFRS is April 1, 2011, the transition date. IFRS 1 requires first-time adopters to retrospectively apply all effective IFRS standards as of the reporting date, which for the Group is March 31, 2013. However, it also provides for certain optional exemptions and certain mandatory exceptions for first time IFRS adopters.

Initial elections upon adoption:

Set forth below are the applicable IFRS 1 exemptions and exceptions applied by the Group in its transition from previous GAAP to IFRS:

IFRS 1 exemption options:

(a) Employee benefits:

IFRS 1 provides the option to either retrospectively apply IAS 19, *Employee Benefits* and recognize all actuarial gains and losses on employee benefit plans in each prior period or, to recognize in opening retained earnings the cumulative gains and losses deferred under previous GAAP at the transition date. The Group has elected to recognize all cumulative actuarial gains and losses that existed at its transition date in opening retained earnings. Accordingly, the Group has increased its liability for employee future benefits and decreased retained earnings by $3.6 million at April 1, 2011. The impact of this change at the transition date and the resulting decrease in amortization of actuarial gains and losses for the year ended March 31, 2012 are shown in the table below:

	As at April 1, 2011	Year ended March 31, 2012
Differences from amounts reported under previous GAAP:		
Retained earnings (decrease) – beginning of period	–	(3,552)
Cumulative actuarial losses recognized	(3,552)	–
Decrease in amortization of actuarial losses	–	217
Retained earnings (decrease) – end of period	(3,552)	(3,335)

(b) Previous GAAP carrying amount as deemed cost:

IFRS 1 provides the option to use as deemed cost at the transition date, the previous GAAP carrying amount of property, plant and equipment or intangible assets that are used, or were previously used, in operations subject to rate regulation. This exemption need not apply to all items. At transition date, an entity must also test for impairment in accordance with IAS 36, each item for which this exemption is used. The Group has elected to recognize all property, plant and equipment and intangible assets that existed at its transition date at previous GAAP carrying amounts, with the exception of land. The carrying amounts of these assets were not in excess of their recoverable amounts and therefore no impairment was recognized. The election of this exemption did not result in a change to the carrying amounts of these assets.

(c) Fair value as deemed cost:

IFRS 1 provides the option to measure, at transition date, an item of property, plant and equipment or intangible assets at its fair value and use that fair value as its deemed cost at that date. The Group has elected to recognize all land assets at fair value. Accordingly, the Group has increased property, plant and equipment and retained earnings by $12.2 million each at April 1, 2011. The impact of this change at the transition date and for the year ended March 31, 2012, is shown in the table below:

	As at April 1, 2011	Year ended March 31, 2012
Differences from amounts reported under previous GAAP:		
Equity increase – beginning of period	–	12,187
Fair value increase in carrying value of land assets	12,187	2,177
Equity increase – end of period	12,187	14,364

IFRS 1 mandatory exceptions:

(d) Estimates:

The estimates previously made by the Group under previous GAAP have not been revised for the application of IFRS except where necessary to reflect any difference in accounting policies.

Significant accounting policy differences:

In addition to the exemptions and exceptions discussed above, the following explains the significant differences between the previous GAAP policies and the current IFRS policies applied by the Group.

(e) Rate regulation:

Under previous GAAP, the Group followed Accounting Guideline 19 *"Disclosures by Entities Subject to Rate Regulation"* (AcG-19) of the CICA Handbook which established guidelines on certain aspects of the disclosure and presentation of information in the financial statements of entities subject to rate regulation.

In order to recognize the economic effects of rate regulation, timing differences relating to recognition of certain revenues and expenses gave rise to regulatory assets and regulatory liabilities in the financial statements.

IFRS does not currently contain any guidance relating to recognition of assets and liabilities that have arisen as a result of rate regulation. Under current IFRS standards, such items have not been recognized on transition.

Accordingly, the Group has derecognized at transition, current regulatory assets of $3.7 million and long-term regulatory liabilities of $1.6 million, resulting in a net reduction in retained earnings of $2.1 million at April 1, 2011. The impact of the derecognition of regulatory assets and regulatory liabilities at the transition date, and for the year ended March 31, 2012 are shown in the table below:

	As at April 1, 2011	Year ended March 31, 2012
Differences from amounts reported under previous GAAP:		
Derecognition at transition:		
Current regulatory assets decrease	(3,703)	(3,703)
Long-term regulatory liabilities decrease	1,558	1,558
Retained earnings (decrease) – beginning of period	(2,145)	(2,145)
Effect of derecognition on net earnings for the period:		
Vehicle and passenger fares increase	–	14,487
Ferry service fees increase	–	3,302
Operations expense – fuel expense (increase)	–	(19,487)
Administration expense – contracted services (increase)	–	(94)
Amortization expense decrease	–	4,775
Finance expense decrease	–	40
Net earnings increase	–	3,023
Retained earnings (decrease) increase – end of period	(2,145)	878

(f) Research and training costs:

The Group previously capitalized research and training costs that were directly attributable to assets where these costs were included within the Group's rate-regulated asset base.

Under IAS 16 – *Property, Plant and Equipment* and IAS 38 – *Intangible Assets*, research and training costs do not qualify for capitalization. The impact of expensing research and training costs for the year ended March 31, 2012 is shown in the table below:

	Year ended March 31, 2012
Differences from amounts reported under previous GAAP:	
Property, plant and equipment (decrease)	(574)
Intangible assets (decrease)	(158)
Decrease in non-current assets	(732)
Operating expenses increase:	
Operations expense – Salaries, wages, benefits and consulting	(594)
Administration expense – contracted services	(130)
Total operating expenses increase	(724)
Finance expenses increase	(8)
Retained earnings (decrease)	(732)

(g) Major overhauls and inspections

IAS 16, *Property, Plant and Equipment*, requires each item of property, plant and equipment with a significant cost in relation to the total cost and a different useful life to be depreciated separately. The Group incurs significant costs for periodic inspection and maintenance performed on its vessels at predetermined time intervals to maintain the integrity and efficiency of the vessel and its major components. IFRS requires the costs of these activities that restore the service potential of the vessel's hull, propulsion system and generators to be separately capitalized and depreciated over the period until the next inspection and/or overhaul. Under previous GAAP these costs have been expensed as incurred. Timing of inspection and major overhauls vary by class of vessel and are done on a periodic basis every two to five years. At transition, the Group quantified these inspection and major overhaul costs for each vessel and reclassified the carrying value to be depreciated over the lesser of the period to the next scheduled inspection and major overhaul or the remaining useful life of the vessel. There is no change to the cost of maintenance activities and no overall impact to earnings over the life of the vessel, only a timing difference in expense recognition. The impact of capitalizing major overhauls and inspections for the year ended March 31, 2012 is shown in the table below:

	Year ended March 31, 2012
Differences from amounts reported under previous GAAP:	
Property, plant and equipment:	
Major overhauls and inspections capitalized	20,363
Less: Depreciation expense for the year	(15,353)
Property, plant and equipment increase	5,010
Maintenance expense decrease	20,361
Loss on disposal	2
Depreciation expense (increase)	(15,353)
Retained earnings increase	5,010

Financial statement presentation changes:

IAS 1, *Financial Statements*, requires an entity to present provisions separately on the face of the consolidated statement of financial position. Accordingly, the following reclassifications were made at the transition date, and March 31, 2012:

	As at	
	April 1, 2011	March 31, 2012
Differences from amounts reported under previous GAAP:		
Accounts payable and accrued liabilities decrease	1,377	1,277
Accrued employee costs decrease	45,411	45,745
Provisions increase	46,788	47,022

Reconciliations of previous GAAP to IFRS for comparative periods:

IFRS 1 requires an entity to provide a reconciliation of equity, comprehensive income and cash flows for all comparative periods presented.

Interest paid is now reported within the statement of cash flows, whereas it was previously disclosed as supplementary information. There are no other material differences between the statement of cash flows reported under previous GAAP to the statement of cash flows reported under IFRS.

A reconciliation from previous GAAP to IFRS equity as at April 1, 2011 and March 31, 2012 is provided below with reference to the changes described above:

Reconciliation of equity:

		As at	
	Note	April 1, 2011	March 31, 2012
Previous GAAP equity		308,699	311,187
IFRS adjustments to equity:			
Employee benefits	a	(3,552)	(3,335)
Fair value of land	c	12,187	14,364
Derecognition of regulatory assets/liabilities	e	(2,145)	878
Research and training	f	–	(732)
Major overhauls and inspections	g	–	5,010
Total IFRS adjustments to equity		6,490	16,185
IFRS equity		315,189	327,372

Reconciliation of previous GAAP to IFRS comprehensive income for the year ended March 31, 2012 is provided below with reference to the changes described above:

Reconciliation of comprehensive (loss) income:

		Year ended
	Note	March 31, 2012
Previous GAAP comprehensive (loss) income		(16,474)
Employee benefits	a	217
Derecognition of regulatory assets/liabilities	e	3,023
Research and training costs	f	(732)
Major overhauls and inspections	g	5,010
Total IFRS adjustments to net earnings		7,518
Net (loss) earnings		(8,956)
Other comprehensive income:		
Revaluation increase of land assets	c	2,177
IFRS comprehensive (loss) income		(6,779)

British Columbia Ferry Services Inc.

BOARD OF DIRECTORS

During the fiscal year ended March 31, 2013, the board was composed of the following directors.

Donald P. Hayes
Chair

Holly A. Haston-Grant

Guy D. Johnson *[effective August 25, 2012]*

Brian G. Kenning

Gordon R. Larkin

Maureen V. Macarenko

P. Geoffrey Plant, QC

Wayne H. Stoilen

Graham M. Wilson

Effective April 1, 2013, Jane M. Bird *and* John A. Horning *became directors.*

SENIOR OFFICERS OF THE COMPANY

(effective April 1, 2012)

Michael J. Corrigan
President & Chief Executive Officer

Robert P. Clarke
Executive Vice President & Chief Financial Officer

Glen N. Schwartz
Executive Vice President, Human Resources & Corporate Development

OFFICERS OF THE COMPANY

(effective April 1, 2012)

Janet E. Carson
Vice President, Marketing & Travel Services

Mark F. Collins *[ceased November 2, 2012]*
Vice President, Engineering

L. Blaine Ellis *[ceased June 30, 2012]*
Vice President, Employee Relations

M. Alana Gallagher
Treasurer

Cynthia M. Lukaitis
Vice President & Corporate Secretary

Captain D.W. James Marshall
Vice President, Fleet Operations

Mark S. Stefanson *[ceased June 30, 2012]*
Vice President, Public Affairs

Corrine E. Storey
Vice President, Customer Services

Pierre Vorster
Vice President & Chief Information Officer

Mark C. Wilson *[effective November 3, 2012]*
Vice President, Engineering

British Columbia Ferry Services Inc.
500 – 1321 Blandshard St., Victoria,
British Columbia V8W 0B7

www.bcferries.com
www.bcferryauthority.com